No. 88-348-CFX
Status: GRANTED

Title: New Orleans Public Service, Inc., Petitioner
v.
Council of City of New Orleans, et al.

Docketed:
August 26, 1988

Court: United States Court of Appeals
for the Fifth Circuit

Counsel for petitioner: Lee,Rex E.

Counsel for respondent: Vince,Clinton A.

Entry	Date	Note	Proceedings and Orders
11	Feb 14 1988		Order extending time to file response to petition until February 27, 1989.
1	Aug 26 1988	G	Petition for writ of certiorari filed.
2	Sep 26 1988		Brief of respondents in opposition filed.
3	Sep 28 1988		DISTRIBUTED. October 14, 1988
4	Sep 30 1988	X	Reply brief of petitioner New Orleans Public Service, Inc. filed.
5	Oct 17 1988	P	The Solicitor General is invited to file a brief in this case expressing the views of the United States.
6	Dec 8 1988		Brief amicus curiae of United States and FERC filed.
7	Dec 14 1988		REDISTRIBUTED. January 6, 1989
8	Dec 28 1988	X	Brief of respondents in opposition to the views of the United States and FERC as amici curiae filed.
9	Jan 9 1989		Petition GRANTED.
			**********
12	Feb 22 1989		Record filed.
		*	Certified copy of original record and proceedings, 6 volumes, received.
13	Feb 27 1989		Joint appendix filed.
14	Feb 27 1989		Brief amicus curiae of United States filed.
15	Feb 27 1989		Brief of petitioner New Orleans Public Service, Inc. filed.
16	Mar 8 1989		SET FOR ARGUMENT, APRIL 25, 1989. (1st CASE)
17	Mar 8 1989	G	Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
18	Mar 20 1989		Motion of the Acting Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
19	Mar 31 1989		Brief of respondents filed.
20	Mar 31 1989		Brief amicus curiae of Pennsylvania Public Utility Commission filed.
21	Mar 31 1989		Brief amici curiae of National League of Cities, et al. filed.
22	Mar 31 1989		Brief amicus curiae of National Assn. of Regulatory Utility Commissioners filed.
23	Apr 3 1989		CIRCULATED.
24	Apr 18 1989	X	Reply brief of petitioner New Orleans Public Service, Inc. filed.
25	Apr 25 1989		ARGUED.

(1)

Supreme Court, U.S.
FILED
AUG 26 1988
JOSEPH F. SPANIOL, JR.
CLERK

88-348

No. 88-_____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

NEW ORLEANS PUBLIC SERVICE INC.,

Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, JOSEPH I. GIARRUSSO, LAMBERT C. BOISSIERE, JR., MICHAEL EARLY, JAMES SINGLETON, DOROTHY MAE TAYLOR, JOHNNY JACKSON, and PEGGY WILSON,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Whether, under the abstention doctrines of *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943), or *Younger* v. *Harris*, 401 U.S. 37 (1971), a federal district court may refuse to adjudicate a federal claim that a federal statute (in this case the Federal Power Act) and the explicit orders of a federal agency (here FERC) have preempted local regulatory authorities from making separate and inconsistent determinations of the very matters FERC has decided?

STATEMENT REQUIRED BY RULE 28.1

Petitioner New Orleans Public Service Inc. ("NOPSI") is a wholly-owned subsidiary of Middle South Utilities, Inc. ("MSU"). MSU has no parent company, and neither MSU nor NOPSI has any subsidiaries that are not wholly-owned by MSU either directly or through other wholly-owned subsidiaries.

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IN THE

Supreme Court of the United States

October Term, 1988

NEW ORLEANS PUBLIC SERVICE INC.,

Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, JOSEPH I. GIARRUSSO, LAMBERT C. BOISSIERE, JR., MICHAEL EARLY, JAMES SINGLETON, DOROTHY MAE TAYLOR, JOHNNY JACKSON, and PEGGY WILSON,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix ("App.") 1A-20A) is not yet published. The opinion of the District Court (App. 21A-33A) is unpublished.

JURISDICTION

The opinion and judgment of the Court of Appeals were entered on July 28, 1988. App. 1A-20A & 35A. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

This case presents a question that is one of the most widely litigated and widely controverted in the federal system: whether abstention principles prohibit a federal district court from adjudicating a claim that a federal statute (here the Federal Power Act) vests exclusive jurisdiction over certain matters in a federal

regulatory agency (here the Federal Energy Regulatory Commission ("FERC")) and thereby preempts a local utility commission from making its own determination of those matters. The rule in the Fifth Circuit squarely conflicts with decisions of the Third, Fourth, Eighth, Ninth, Eleventh, and District of Columbia Circuits. Only the Sixth Circuit and one decision of the Fourth Circuit are consistent with the Fifth Circuit rule on this abstention issue. Accordingly, eight circuits are involved in the conflict. As the Fifth Circuit stated in this case, "[o]nly [the Supreme] Court can resolve the conflict among the federal courts about the appropriateness of abstention in this situation, and it has not yet spoken." App. 20A.

In 1986, the Court invited the Solicitor General to state the views of the United States on whether this abstention issue should be reviewed.[1] The United States and FERC then demonstrated that this conflict was impairing the enforcement of the Federal Power Act, and urged the Court to resolve the conflict in the context of an earlier phase of the very controversy that is at issue here.[2] However, at that time, litigation of the underlying Federal Power Act claim was contended (and later held) to be independently barred by principles of ripeness. The Solicitor General's Memorandum noted these "procedural problems," and the Court declined to review the abstention issue.[3]

Now the underlying federal claim is indisputably ripe. The Council of the City of New Orleans has finally denied recovery

[1]*See American Electric Power Co.* v. *Kentucky Public Service Commission,* 55 U.S.L.W. 3231 (Oct. 6, 1986).

[2]Brief for United States and Federal Energy Regulatory Commission As Amici Curiae, *American Electric Power Co.* v. *Kentucky Public Service Comm'n,* No. 86-49 (March, 1987), p. 16 ("We urge the Court to grant review [of the abstention question], instead in NOPSI.") (hereinafter "Solicitor General's 1987 NOPSI Mem.").

[3]*See New Orleans Public Service, Inc.* v. *New Orleans,* 107 S. Ct. 1910 (1987); *American Electric Power Co.* v. *Kentucky Public Service Comm'n,* 107 S.Ct. 1910 (1987).

of $135 million of petitioners' FERC-mandated costs, and the Council has ordered rate reductions to implement this "prudence" disallowance. Moreover, the City Council has continued to claim that this prudence disallowance is permissible, notwithstanding this Court's unequivocal June 24, 1988 holding in *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore,* No. 86-1970, 56 U.S.L.W. 4751 (June 24, 1988), that local regulatory authorities have no jurisdiction to disallow any of the same federally-mandated costs that are at issue here, on grounds of prudence or otherwise.

In short, this issue will not go away, and the conflict between the courts of appeals should be resolved now.

1. Factual Background. This case arises from the same facts and the same FERC orders at issue in *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore,* No. 86-1970, 56 U.S.L.W. 4751 (June 24, 1988). Here, as there, local utility regulators are attempting to use their retail ratemaking authority to nullify the FERC decisions (Opinions 234, 234A, 292 and 292A) that allocated the costs of the Grand Gulf 1 nuclear plant among the retail operating company subsidiaries of Middle South Utilities, Inc. ("MSU").

Petitioner New Orleans Public Service Inc. ("NOPSI") provides retail electric services in the City of New Orleans. Under Louisiana law, NOPSI's retail rates are regulated by the Council of the City of New Orleans ("Council").

Like Mississippi Power & Light Company ("MP&L"), NOPSI is a wholly-owned subsidiary of MSU. NOPSI is one of the four companies that "[t]hrough MSU . . . operate as an integrated power pool" and that exchange power among themselves at rates established by FERC. *Mississippi Power & Light Co.,* 56 U.S.L.W. at 4752, slip op. at 2. Like MP&L, NOPSI is thus subject to two FERC-approved rate schedules that determine how the costs of

Grand Gulf 1 are allocated: the 1982 System Agreement and the Unit Power Sales Agreement ("UPSA"). *See* 56 U.S.L.W. at 4753-54, slip op. at 5-9.

As originally filed, the rate schedule allocated to NOPSI 29.80% of the costs and output of Grand Gulf 1. The City of New Orleans ("City") participated extensively in the massive FERC proceedings that followed (*see* 56 U.S.L.W. at 4753-54, slip op. at 5-9; App. 4A), and the City urged that NOPSI be responsible for only 9% of Grand Gulf 1. Although FERC ordered a substantial reduction in NOPSI's allocation, FERC rejected the City's position and mandated a 17% allocation of Grand Gulf 1 for NOPSI.

Thus, when Grand Gulf 1 began commercial operations on July 1, 1985, NOPSI was required under the FERC order to begin incurring Grand Gulf 1 costs of approximately $15.5 million per month.

2. Prior Proceedings. On May 17, 1985, NOPSI filed an application with the Council for the retail rate increase required to recover its Grand Gulf 1 costs. This application was not granted by the Council. Instead, the Council, on October 17, 1985, adopted a resolution initiating an investigation into the prudence of NOPSI's involvement in Grand Gulf 1.

When the Council failed to act upon NOPSI's initial application, on August 1, 1985, NOPSI filed an action in federal district court to enforce its right to recover these FERC-mandated costs (*"NOPSI I"*). The District Court dismissed the suit under the Johnson Act and abstention principles. On February 22, 1986, the Fifth Circuit issued an opinion that reversed on both grounds, and remanded for a determination whether the "filed rate" doctrine required recognition of these costs. *New Orleans Public Service, Inc.* v. *New Orleans,* 782 F.2d 1236 (5th Cir. 1986). However,

on September 2, 1986, the Fifth Circuit, on its own motion, reversed itself, vacated the abstention discussion in its earlier opinion, and held that the District Court did not abuse its discretion in abstaining under the abstention doctrine articulated in *Burford* v. *Sun Oil Co.,* and possibly under the abstention doctrine established in *Younger* v. *Harris* as well. *Id.,* 798 F.2d 858 (5th Cir. 1986).

While the case was pending on appeal, NOPSI and the Council entered into a settlement in March, 1986. The settlement allowed a phased-in rate increase under which NOPSI would eventually recover all but $51 million of its Grand Gulf 1 costs, although any recovery was subject to the outcome of the ongoing prudence investigation. Under the settlement, NOPSI reserved its right to pursue its claim that the Council had no jurisdiction to conduct this prudence inquiry, and the Council, in turn, reserved its right to order adjustments in NOPSI's rates on the basis of that investigation.

The Council relied on this settlement agreement in opposing NOPSI's petition for certiorari from the September, 1986 Fifth Circuit decision in *NOPSI I.* The Council argued that the agreement mooted the case and also made the Federal Power Act claims not ripe. Although the United States believed that these facts did not detract from the appropriateness of a decision on the abstention issue in this case, these and related facts led the Solicitor General to state that "*NOPSI*[I] is not wholly free from procedural problems." Solicitor General's 1987 NOPSI Mem., p. 25.

The extent of the apparent ripeness problems was made manifest in a parallel case *(NOPSI II)* that NOPSI brought in November, 1985 to enjoin the Council's prudence inquiry. In defending that case, the Council stated that its pending prudence inquiry *would* fully recognize the FERC-mandated Grand Gulf 1 expenses

and would deal solely with whether NOPSI had achieved savings in other areas. This representation led the Fifth Circuit to hold that the underlying Federal Power Act claim was not ripe and to decline to reach the abstention issues. *New Orleans Public Service, Inc.* v. *New Orleans,* 833 F.2d 583, 588 (5th Cir. 1987).

3. This Case. There are no ripeness or procedural problems in this case. It is based on the *actual results* of the Council's prudence investigation, which was completed by adoption of a rate order on February 4, 1988. The order violates the Council's prior representations to the Fifth Circuit. It disallows $135 million in previously incurred, FERC-mandated Grand Gulf 1 expenses, and the Council's order implements this prudence disallowance by ordering reductions in NOPSI's future rate increases by approximately $500,000 per month this year, and by multiples of that amount in future years. This $135 million of "trapped costs" is in addition to the $51 million that NOPSI previously agreed to absorb in the March, 1986 Settlement with the Council.

The basis for the Council's $135 million disallowance is its decision to set NOPSI's rates to allow full recovery of only 9% of Grand Gulf 1—the same percentage that New Orleans had unsuccessfully urged in the FERC proceedings (*see* App. 11A)—and to permit recovery of the remaining 8% at the hypothetical costs of alternative coal-fired generation. The Council asserted that NOPSI had behaved "imprudently" in monitoring the costs of Grand Gulf 1, and in failing to sell a substantial portion of its share of Grand Gulf 1 off-system in 1979-80 (five to six years before either the rates for the power or the allocation had been established by FERC). As the Fifth Circuit stated in this case, this prudence disallowance appears to be squarely foreclosed by this Court's decision in *Mississippi Power & Light Co., supra.* App. 13A.

On February 9, 1988, NOPSI filed suit in federal district court to enjoin this violation of its federal rights.[4] The District Court dismissed the case on March 10, 1988, on grounds of abstention. App. 21A-33A. In the interim, there has been no resolution of any parallel state court proceedings, despite the trapping of FERC-mandated costs and resulting financial harm that occur each day. *See* App. 10A.[5]

On July 28, 1988, the Fifth Circuit affirmed. It held that the Fifth Circuit's earlier abstention decision was binding on it unless and until this Court resolved the conflict in the courts of appeals. App. 20A.

REASONS FOR GRANTING THE WRIT

The question whether abstention principles deprive federal district courts of authority to prevent state utility commissions from interfering with the exclusive jurisdiction of FERC (or other federal agencies) has become one of the most important and frequently recurring questions facing the federal judiciary. When the question was presented to the Court four years ago, only the Fourth Circuit had squarely addressed this issue.[6] This Court

[4]On the date of its order, the Council filed an action in the Civil District Court for the Parish of Orleans, Louisiana, seeking a declaratory judgment that its prudence order was lawful. That action was removed to federal district court and consolidated with the instant case. The state action was remanded to state court, however, after the federal court decided to abstain in this case.

[5]Because of the uncertainty over the availability of a federal forum, NOPSI, on March 7, 1988, filed a petition to review the Council's order in the Civil District Court for the Parish of Orleans, Louisiana. No hearing has occurred on the merits. On May 5, 1988, the state court denied NOPSI's motion for a preliminary injunction. NOPSI has appealed the denial of that motion. The intermediate Louisiana appellate court, however, has twice refused to expedite this interlocutory appeal, and the matter, therefore, will not be resolved before next year.

[6]*Aluminum Co. of America* v. *Utilities Comm'n of North Carolina,* 713 F.2d 1024 (4th Cir. 1983), *cert. denied,* 465 U.S. 1052 (1984). There, Alcoa had sought to litigate in federal district court the identical factual and legal claims under the Federal Power Act that this Court subse-

(Footnote continued on next page)

denied certiorari, with Justices Brennan and White noting that they would have granted the petition. *Aluminum Co. of America* v. *Utilities Commission of North Carolina,* 465 U.S. 1052 (1984). In the intervening years, litigation of this question has burgeoned. Five circuits have addressed this abstention issue in cases presenting the same Federal Power Act (or Natural Gas Act)[7] preemption claims involved here.[8] In addition, other circuits have addressed the abstention issue in other closely related contexts.[9]

(Footnote continued from preceding page)
quently decided in *Nantahala Power & Light Co.* v. *Thornburg,* 476 U.S. 953 (1986). The Fourth Circuit upheld the District Court's decision to abstain in that case, but in a subsequent case held that a decision not to abstain was proper. *Appalachian Power Co.* v. *Public Service Comm'n of West Virginia,* 770 F.2d 159 (4th Cir. 1985), *aff'g* 614 F.2d 64 (S.D. W. Va. 1985). Even in *Alcoa,* the Fourth Circuit acknowledged that abstention would not be appropriate where, as here, preemption was clear. 713 F.2d at 1029-30.

[7]This Court has stated many times that the "relevant provisions of [the Natural Gas Act and the Federal Power Act] 'are in all material respects substantially identical'" and that it is the Court's "established practice" to "cit[e] interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkansas Louisiana Gas Co.* v. *Hall,* 453 U.S. 571, 577 n.7 (1981) (citations omitted).

[8]*Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Utility Comm'n,* 791 F.2d 1111 (3rd Cir. 1986) (court should not abstain from deciding Natural Gas Act claim); *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n,* 772 F.2d 404 (8th Cir. 1985) (court should not abstain from deciding Federal Power Act claim), *cert. denied,* 474 U.S. 1102 (1986); *Arkansas Power & Light Co.* v. *Missouri Public Service Comm'n,* 829 F.2d 1444 (8th Cir. 1987) (court should not abstain from deciding Federal Power Act claim); *Appalachian Power Co.* v. *Public Service Comm'n of West Virginia,* 770 F.2d 159 (4th Cir. 1985), *affg* 614 F.Supp. 64 (S.D. W. Va. 1985) (court should not abstain from deciding Federal Power Act claim); *New Orleans Public Service, Inc.* v. *New Orleans,* 782 F.2d 1236 & 798 F.2d 858 (5th Cir. 1986) (upholding abstention on Federal Power Act claim), *cert. denied,* 107 S. Ct. 1910 (1987); *American Electric Power Co.* v. *Kentucky Public Service Comm'n,* 787 F.2d 588 (6th Cir. 1986) (same), *cert. denied,* 107 S. Ct. 1910 (1987).

[9]*Champion Int'l Corp.* v. *Brown,* 731 F.2d 1406 (9th Cir. 1984) (abstention inapplicable where ERISA preempts state age discrimination

(Footnote continued on next page)

The rule in the Fifth Circuit on this abstention question conflicts with decisions of five other courts of appeals as well as with the pertinent decisions of this Court. Thus, the conflict has spread to eight circuits, with five favoring the petitioner's view, two opposed, and the Fourth Circuit divided. *See* p. 8 nn.8 & 9, *supra.*

For these reasons, in response to this Court's request, the United States in 1987 urged the Court to grant certiorari to review the *NOPSI I* decision and to reject the Fifth Circuit's rule. *See* Solicitor General's 1987 NOPSI Mem., pp. 20-23. The Solicitor General made this recommendation at a time when the controversy was clouded by claims of lack of ripeness and by related "procedural problems." *Id.,* p. 25. The Court at that time declined the Solicitor General's invitation.

Now, however, the issue is squarely presented; there is no ripeness issue, and any possible procedural problems have vanished. *See* pp. 5-7, *supra.* The intervening events further confirm the Solicitor General's prediction that this abstention issue will not go away, but will recur, again and again. As the Fifth Circuit's opinion in this case correctly states, only this Court can resolve the conflict. *See* App. 20A.

1. The rule in the Fifth Circuit is that federal district courts have discretion to abstain from deciding claims that local utility regulators have violated federal rights conferred by federal statutes (*e.g.,* the Federal Power Act) that preempt state regulation. The Fifth Circuit reasons that these federal claims should be raised in appeals from state retail rate orders in state courts. This Court's holdings teach that the Fifth Circuit's rule must be rejected.

(Footnote continued from preceding page)
laws); *Family Division Trial Lawyers* v. *Moultrie,* 725 F.2d 695 (D.C. Cir. 1984) (abstention inapplicable to constitutional challenge to local judicial administration); *Baggett* v. *Dept. of Professional Regulation,* 717 F.2d 521 (11th Cir. 1983) (abstention inappropriate to claim that state had no jurisdiction to discipline federally licensed marine pilot).

This Court has held that a federal court may not exercise "judicial discretion to dismiss a suit merely because a State court could entertain it" and that a federal court can abstain from "adjudicat[ing] a controversy properly before it . . . . only in the exceptional circumstances where the order to the parties to repair to the State court would clearly serve an important countervailing interest." *Colorado River Water Conservation Dist.* v. *United States,* 424 U.S. 800, 813-14 (1976).

This Court's holdings teach that state courts cannot have an overriding interest in adjudicating whether Congress has intended that a federal regulatory agency have exclusive jurisdiction over certain matters and therefore has preempted contrary state action. This Court has upheld the authority of federal courts to enjoin state utility commission action on the same basic preemption grounds presented here, and has rejected arguments that state remedies must be exhausted—without even addressing whether abstention was required or permitted. *See, e.g., Public Utilities Comm'n of California* v. *United States,* 355 U.S. 534, 540 (1958); *Public Utilities Comm'n of Ohio* v. *United Fuel Gas Co.,* 317 U.S. 456 (1943); *see also Schneidewind* v. *ANR Pipeline Co.,* No. 86-986, 56 U.S.L.W. 4249 (Mar. 22, 1988).

These principles apply with special force in cases presenting federal preemption claims under the Federal Power Act. The Act establishes a federal agency (FERC) to referee disputes among states on the allocation of low-cost and high-cost electric power supplies. The purposes of the Act would be frustrated if individual states could act based on local concerns and collaterally attack the FERC's allocation by adopting allocations (or rates reflecting allocations) that prefer their interests to those sought to be protected by the FERC. *See Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore,* No. 86-1970, 56 U.S.L.W. 4751 (June 24, 1988); *Nantahala Power & Light Co.* v. *Thornburg,* 476 U.S. 953 (1986). Unless federal district courts have authority to enforce the FERC-established federal rights under the filed rate doctrine,

states can thwart the federal regulatory scheme and subvert interstate power supply arrangements adopted thereunder. Given this Court's limited resources, it is both impractical and unrealistic to expect that the entire burden of reviewing state actions in these cases can or ought to rest here.

2. The Fifth Circuit rule of abstention is based on this Court's holding in *Burford* v. *Sun Oil Co.,* 319 U.S. 315 (1943). However, this Court, and numerous federal courts of appeals, have held that *Burford* is a narrow exception to the duty of federal courts to adjudicate claims properly before it, and it is inapposite here. As this Court has held, *Burford* abstention applies only where "difficult questions of state law" are presented and "federal review . . . would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern." *Colorado River Water Conservation District* v. *United States, supra,* 424 U.S. at 814.

Thus, numerous courts of appeals have held that *Burford* cannot support abstention in a case such as this where *no* state law issues are presented and the only issue is whether federal law preempted the state agency from deciding the matter at all. Indeed, the Third and Eighth Circuits have so held in cases presenting the very Federal Power Act (or Natural Gas Act) preemption claims at issue here. As the Eighth Circuit has stated:

> "The very premise of [the *Burford*] doctrine, . . . is lacking when, as here, federal law or Constitution makes the proceeding or regulation at issue beyond the state's authority. There is no concern with protecting a legitimate state regulatory scheme, and the question becomes one of basic federal supremacy, which does not turn on local factors or local expertise."

Middle South Energy, Inc. v. *Arkansas Public Service Comm'n,* 772 F.2d 404, 417 (8th Cir. 1985) (citations omitted), *cert. denied,* 474 U.S. 1102 (1986); *accord, Kentucky West Virginia Gas Co.* v.

Pennsylvania Public Utility Comm'n, 791 F.2d 1111, 1115-16 (3rd Cir. 1986); *Arkansas Power & Light Co.* v. *Missouri Public Service Comm'n,* 829 F.2d 1444 (8th Cir. 1987).

Other courts have reached the identical results in cases arising under other federal statutes. *Knudsen Corp.* v. *Nevada State Dairy Comm'n,* 676 F.2d 374 (9th Cir. 1982); *Baggett* v. *Department of Professional Regulation,* 717 F.2d 521, 524 (11th Cir. 1983); *International Bhd. of Elec. Workers* v. *Public Service Comm'n,* 614 F.2d 206, 212 n.1 (9th Cir. 1980). They, too, hold that *Burford* abstention cannot be applied when there is a substantial federal preemption challenge to a state agency's jurisdiction. Thus, the conflict is stark and clear.[10]

3. The Fifth Circuit also has suggested that abstention under the doctrine of *Younger* v. *Harris,* 401 U.S. 37 (1971), "seems appropriate." *NOPSI I,* 798 F.2d at 863. Under *Younger,* a federal district court cannot enjoin an ongoing state judicial or quasi-judicial enforcement proceeding that implicates important state interests, when there is an adequate opportunity in the state proceeding to raise the federal claim. *See Middlesex County Ethics Committee* v. *Garden State Bar Ass'n,* 457 U.S. 423 (1982).

However, *Younger* abstention is proper only if the state proceeding implicates "important state interests." *Middlesex County Ethics Committee* v. *Garden State Bar Ass'n, supra,* 457 U.S. at 432. Contrary to the Fifth Circuit holding, other courts of appeals have held that the state interest in regulating retail rates, however important, cannot give the state an "overriding interest" in adjudicating federal preemption claims that go to the "power of the

[10]Indeed, the Solicitor General told this Court in 1987, after discussing various courts of appeals holdings, that these decisions "amply reveal a clear circuit conflict on the important issue whether abstention is appropriate in the context of a preemption claim based on the filed rate doctrine." Solicitor General's 1987 NOPSI Mem., p. 22 n.13.

state administrative agency to proceed at all;" "no deference is due state proceedings which would entrench upon the exclusive federal domain." *Baggett* v. *Department of Professional Regulation,* 717 F.2d 521, 524 (11th Cir. 1983).

Three courts of appeals have now held that *Younger* abstention is improper in suits raising the precise Federal Power Act preemption claims at issue here. They reason that the "legitimate state interest contemplated by *Younger* . . . does not exist when the state action has been preempted or foreclosed" by a federal statute, *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n,* 772 F.2d 404, 417 (8th Cir. 1985), and that the "notion of 'comity' embodied by the *Younger* doctrine is 'not strained when a federal court cuts off state proceedings that entrench upon the federal domain.'" *Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Utility Comm'n,* 791 F.2d 1111, 1117 (3rd Cir. 1986) (citations omitted); *accord, Appalachian Power Co.* v. *Public Service Comm'n of West Virginia,* 614 F.Supp. 64, 70-71 (S.D. W. Va.), *aff'd,* 770 F.2d 159 (4th Cir. 1985). *See also Champion Int'l Corp.* v. *Brown,* 731 F.2d 1406, 1409 (9th Cir. 1984).

4. The issue in this case is whether the Council can disregard FERC's exclusive jurisdiction over the question of the prudence, and the allocation, of the costs of Grand Gulf 1. This question has been conclusively decided. *See Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore, supra; Nantahala Power & Light Co.* v. *Thornburg,* 476 U.S. 953 (1986). As Justice Scalia stated, *Mississippi Power & Light* establishes "who has jurisdiction, FERC or the States, to evaluate the prudence of a particular utility's entering pooling arrangements with affiliated companies." *Mississippi Power & Light Co., supra,* 56 U.S.L.W. at 4759 (Scalia, J., concurring), slip op. at 7. Although the point should be obvious to any objective reader, it has been ignored by the New Orleans City Council. NOPSI thus seeks nothing more than its estab-

lished rights under federal law. There is no state law issue, and this case epitomizes the type of cases that federal district courts were created to decide.

Neither this Court's precedents, common sense, nor deference to state courts requires or permits federal abstention in this case. In any of at least five other circuits, the door of the federal courthouse would have been open to petitioner. Indeed, NOPSI's affiliates were able to obtain the federal court injunction required to prevent a different state utility commission from interfering with recovery of FERC-mandated Grand Gulf 1 costs.[11] Such an important issue as the availability of federal courts to vindicate federal rights cannot depend on the fortuity of whether the supplicant and the courthouse are in Arkansas or Louisiana.

[11] *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 772 F.2d 404 (8th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986). *See Arkansas Power & Light Co.* v. *Missouri Public Service Comm'n*, 829 F.2d 1444 (8th Cir. 1987).

CONCLUSION

For the reasons stated, the petition for writ of certiorari should be granted.

Respectfully submitted,

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Dated: August 26, 1988

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COURT OF APPEALS OPINION
[JULY 28, 1988]

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

NO. 88-3194

NEW ORLEANS PUBLIC SERVICE, INC.,

Plaintiff-Appellant,

versus

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL,

Defendants-Appellees.

Appeal from the United States District Court for the Eastern District of Louisiana

(July 28, 1988)

Before RUBIN, GARZA and JONES, Circuit Judges.

RUBIN, Circuit Judge:

In 1986 this court decided that a federal district court had not abused its discretion in abstaining from deciding federal issues presented in suit to enjoin a state agency's proceeding to fix the retail rates that might be charged by a public utility. Bound by this decision, we hold again that the same distict court did not abuse its discretion in failing to take jurisdiction over issues of federal law at a later stage of the same proceeding.

I.

This is the fourth federal court battle in a legal war that began almost a decade ago. New Orleans Public Service, Inc. (NOPSI), a subsidiary of Middle South Utilities, Inc., a public utility

holding company, sells electric power to consumers in the City of New Orleans. It continues to seek a federal forum for its claims against the New Orleans City Council, which by state law fixes the utility rates charged consumers in New Orleans. It charges that the Council is violating federal law by preventing NOPSI from passing on to the consumers all of the costs of NOPSI'S purchase of power generated by a nuclear reactor at rates fixed by the Federal Energy Regulatory Commission (FERC).

Middle South owns and therefore controls Louisiana Power & Light Co., Mississippi Power & Light Co., Arkansas Power & Light Co., and NOPSI, collectively known as the Middle South Companies, all of which are engaged in distributing energy, as well as System Energy Resources, Inc. (SERI), which generates energy. In the late 1960's, Middle South sought to meet projected increases in demand and to diversify the fuel base of its entire system by adding coal and nuclear generating units. Because Middle South found it impractical for each of the four operating companies to finance and construct a nuclear power facility, it formed a new subsidiary, Middle South Energy, Inc. (MSE), a corporate predecessor of SERI, to finance, own, and operate two nuclear reactors, Grand Gulf I and II. Middle South later decided for economic reasons not to build Grand Gulf II, but to proceed with the construction of Grand Gulf I, a 1250 megawatt nuclear generating plant. In 1974, NOPSI, Louisiana Power, Mississippi Power, and Arkansas Power all committed themselves to sharing the construction cost of Grand Gulf, which MSE projected to be $875 million.

After the nuclear disaster at Three Mile Island, federal regulatory authorities adopted stricter regulations for the construction of nuclear plants. As a result of this and other factors, construction of the Grand Gulf nuclear plant took longer and became drastically more expensive than originally anticipated, amounting in the end to $3.6 billion. Consequently, the wholesale cost of power produced at Grand Gulf greatly exceeds that of power

produced in other system facilities. Moreover, even as Grand Gulf was under construction, it became clear that the demand for its energy would be less than originally anticipated.

In 1982, the Middle South Companies submitted to FERC, which has exclusive jurisdiction over interstate wholesale power rates,[1] two agreements. The first was a new System Agreement, which set forth the terms and conditions for coordinated operations and wholesale transactions among the four companies, including a scheme of capacity equalization payments, which were designed to ensure that each company contribute proportionately to the total costs of generating power for the system. The second was a Unit Power Sales Agreement, which provided wholesale rates for the sale of Grand Gulf capacity and energy to the operating companies. The Unit Power Sales Agreement allocated 29.8% of the Grand Gulf costs to NOPSI.

FERC assigned each agreement to a different administrative law judge, charging them with the task of determining whether the agreements were "just and reasonable" within the meaning of the Federal Power Act.[2] Each ALJ held extensive hearings, in which numerous parties representing consumer interests and the various state regulatory agencies participated. At these hearings, the New Orleans City Council appeared to protest the proposed rates and the allocations made pursuant to the Sales Agreement. The City Council and other utility regulatory bodies argued that FERC should reduce the allocations of the high-cost and hence relatively unattractive nuclear power to their constituents.

Three years later, in 1985, FERC issued an order modifying the Sales Agreement to provide for the allocation of power and costs from Grand Gulf as follows: 17 percent to NOPSI, 14 percent to Louisiana Power, 33 percent to Mississippi Power, and 36

[1]16 U.S.C. § 824(b) (1982); Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953, ___, 106 S.Ct. 2349, 2352 (1986); *see also* 16 U.S.C. §§ 824d, 824e (1982).

[2]16 U.S.C. § 824(a) (1982).

percent to Arkansas Power.[3] As the Supreme Court noted in Mississippi Power & Light Co. v. Mississippi ex rel Moore,[4]

> [FERC] did not expressly discuss the "prudence" of constructing Grand Gulf and bringing it on line, [but it] implicitly accepted the uncontroverted testimony of the [Middle South] executives who explained why they believed the decisions to construct and to complete Grand Gulf I were sound, and approved the finding that "continuing construction of Grand Gulf Unit No. 1 was prudent because Middle South's executives believed Grand Gulf would enable the Middle South system to diversify its base load fuel mix and, it was projected, at the same time, produce power for a total cost (capacity and energy) which would be less than existing alternatives on the system."[5]

The state regulatory agencies appealed the FERC allocations, and the United States Court of Appeals for the District of Columbia Circuit reversed the FERC decision.[6] On remand, however, FERC reaffirmed its original 1985 allocations.[7]

NOPSI appealed to the New Orleans City Council in 1985 for a retail rate increase to cover the increase in wholesale costs that the FERC order would require it to pay. The Council responded with a resolution initiating an investigation into "all aspects of NOPSI's prudence regarding its decisions to enter into its arrangements to purchase a portion of Grand Gulf 1 for the purpose of determining what portion, if any, of NOPSI's Grand Gulf 1

[3]Opinion and Order Setting Just Reasonable and Non-Discriminatory Rates, 31 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,305 (June 13, 1985) (Opinion No. 234).

[4]____ U.S. ____, ____ S.Ct. ____, No. 86-1970 (June 24, 1988).

[5]*Id.* at ____, ____ S.Ct. at ____ (quoting Middle South Energy, Inc., 26 Fed. Energy Reg. Comm'n Rep. (CCH) at ¶¶ 65,112-65,113 (1984)).

[6]Mississippi Indus. v. FERC, 822 F.2d 1104 (D.C. Cir.), *cert. denied.* 108 S.Ct. 501 (1987).

[7]System Energy Resources, Inc., 41 Fed. Energy Reg. Comm'n Rep. (CCH) ¶ 61,238 (Nov. 30, 1987) (Opinion No. 292).

expense shall be assumed by its shareholders, rather than passed through to its retail ratepayers" (the Prudence Resolution). The Council also refused to approve the rate increase pending the outcome of this investigation.

While the Council was conducting its prudence inquiry, the Supreme Court decided Nantahala Power & Light Co. v. Thornburg,[8] a case that came to the Court on appeal from a state supreme court decision. In *Nantahala,* the Court held that FERC has exclusive jurisdiction over interstate wholesale power rates, and once it has allocated wholesale power, a state regulatory body may not refuse to recognize that allocation. This is a necessary consequence of the filed rate doctrine, which prescribes that interstate power rates filed with or fixed by FERC must be given binding effect by state utility commissions determining intrastate rules.

After the City Council had refused to approve its requested rate increase, NOPSI sought a federal court injunction requiring the Council to pass through, immediately and fully, the increased costs of Grand Gulf to ratepayers and to prevent the Council from conducting its prudence inquiry. The district court dismissed the suit, holding that it lacked subject matter jurisdiction and that, even if it had jurisdiction, it should abstain. While an appeal to this court was pending, in March, 1986, the City Council and NOPSI reached a partial settlement of NOPSI's application for a rate increase. NOPSI agreed to absorb $51.2 million of the costs of Grand Gulf. The Council allowed NOPSI to make a phased interim rate increase, to which NOPSI agreed, in order to moderate the effects of "rate shock" on New Orleans ratepayers. Both parties agreed, however, that this settlement did not affect the Council's continuation of its prudence inquiry.

[8]476 U.S. 953, 106 S.Ct. 2349 (1986).

In *NOPSI I,* this Court initially reversed both district court rulings,[9] but on rehearing affirmed the district court's decision to abstain, in order to avoid interfering with a comprehensive state regulatory scheme.[10] The district court relied upon this opinion, which we will discuss again in detail, in its decision to abstain from hearing the present case.

In April, 1987, the City Council completed its hearings and began deliberations. NOPSI again sought an injunction from the federal district court, arguing that the Council was unreasonably delaying a decision and that its inquiry encroached on areas of exclusive FERC jurisdiction. Later amending its complaint, NOPSI sought only an injunction against any action by the Council that would force NOPSI's shareholders to absorb part of the costs of Grand Gulf that FERC had allocated to NOPSI. NOPSI contended that the announced purpose of the Council's prudence inquiry intruded upon an area within FERC's exclusive jurisdiction. When the district court decided both that the case was not ripe for decision and that, even if it was, it should abstain, NOPSI appealed to this court.

In *NOPSI II,*[11] this court once again noted that the Federal Power Act gives FERC exclusive authority to regulate the wholesale sale of power in interstate commerce while allowing the states to retain their traditional police power to regulate intrastate retail sales. The *NOPSI II* opinion recognized that the Prudence Resolution and the subsequent Council hearing could "certainly be interpreted as directed toward areas now off-limits to state regulators."[12]

[9]New Orleans Pub. Serv., Inc. v. City of New Orleans, 782 F.2d 1236 (5th Cir.), *modified,* 798 F.2d 858 (5th Cir. 1986), *cert. denied,* ___ U.S. ___, 107 S.Ct. 1910 (1987).

[10]New Orleans Pub. Serv. Inc. v. City of New Orleans, 798 F.2d 858 (5th Cir. 1986), *cert. denied,* _____ U.S. _____, 107 S.Ct. 1910 (1987).

[11]New Orleans Pub. Serv., Inc. v. Council of the City of New Orleans, 833 F.2d 583 (5th Cir. 1987).

[12]*Id.* at 586.

The opinion, however, further recognized that the Council's inquiry presented "only a *possibility* of harm to NOPSI. If such harm occurs, the validity of the New Orleans City Council's action will depend on facts not yet in existence."[13] NOPSI would suffer no irreparable harm pending completion of the prudence inquiry. Therefore the injunction issue was not yet ripe, and the Court found it unnecessary to address the district court's alternative decision to abstain.

After completing the lengthy prudence inquiry, the Council adopted a rate order on February 4, 1988. The order disallows $135 million of NOPSI's deferred Grand Gulf costs and requires NOPSI to write this sum off its rate base. It also reduces NOPSI's rate increases, planned to begin on April 9, to reflect this disallowance. The Council based its actions on these conclusions:

(1) NOPSI's oversight and review of its Grand Gulf obligation was uncritical and severely deficient. NOPSI's management remained ignorant of important information and significant events that affected NOPSI's Grand Gulf commitment at the same time that it was attempting to portray Grand Gulf as a great benefit to ratepayers.

(2) NOPSI made no effort to reduce its risk exposure in the wake of the Three Mile Island Nuclear incident in 1979-80, which demonstrated the risks of operating a nuclear reactor. Instead, it committed itself to take a share of the plant that FERC later found to be excessive.

(3) NOPSI imprudently failed to reduce the risk of its Grand Gulf commitment by selling a portion of its share of the power off-system, that is, to some other user. It made no attempt to ascertain whether off-system sales could be accomplished, despite its having made representations to the Council in 1980 that it would sell the power elsewhere if the Council desired.

[13] *Id.* at 588 (emphasis added).

The Council also determined that NOPSI's management was imprudent in committing NOPSI in 1974 to an indeterminate responsibility to pay for Grand Gulf, but it took no action based on this finding. Instead, it concentrated its inquiry and based the disallowance of the rate increase on actions NOPSI's management failed to take at the retail level to reduce the exposure of New Orleans ratepayers to the excessive risks and costs of the Grand Gulf project.

The Council also asserts that, in reaching its decision, it determined that disallowance of the full amount warranted by NOPSI's imprudence would cause NOPSI to become insolvent. It therefore disallowed only that portion of the excess costs—minus an additional ten percent "buffer"—attributable to imprudent management that the Council determined the utility could stand financially.

NOPSI therefore resorted once again to federal court, seeking injunctive and declaratory relief from the Rate Order. It contends that the Order is inconsistent with and preempted by federal law, that the federal courts are vested with exclusive jurisdiction by the Federal Power Act, 16 U.S.C. § 825p, and that, if the Rate Order is allowed to stand, it will suffer irreparable harm. It contends that the Council had assured it in the settlement agreement that it would be allowed to recover the $135 million in deferred costs through future rate increases. The elimination of this asset has drastically reduced its common equity and eliminated its retained earnings. It has been unable to sell rate recovery bonds as it had planned to do in March, 1988, will be unable to sell additional rate recovery bonds for several years, and is threatened with possible calls for redemption of $115 million in outstanding rate recovery bonds. NOPSI states that it also needs funds to continue to pay its FERC-mandated bill for Grand Gulf and other operating expenses. It will be unable to pay dividends on either preferred or common stock for at least several years, and its ability to continue as a viable entity is drastically impaired.

The district court, following this court's decision in *NOPSI I,* found that the Johnson Act[14] did not deprive it of jurisdiction over the suit; it did not have exclusive jurisdiction of the suit under the Federal Power Act; and it should abstain from exercising its jurisdiction, deferring to the state proceedings. Relying on the Supreme Court decision in Burford v. Sun Oil Co.,[15] the court distinguished *Nantahala,* stating that *Nantahala* did not involve a prudence issue. The utility regulatory body in *Nantahala* had simply refused to recognize the FERC allocation without any consideration of managerial prudence or other cost savings available. In this case, on the other hand, the Council had explicity recognized the FERC-allocated costs, but had determined that, given those costs, NOPSI's management should have reduced their impact by selling some of its Grand Gulf power "off system," as its President had earlier said it could do.

The district court based its decision to abstain on the concept stated in *NOPSI I,* that "the regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise."[16] The fact that the Council had completed its prudence inquiry did not end the need for state administrative involvement. The Council's Rate Order is subject to review in Louisiana state court. (In fact, NOPSI has sought an injunction in state court; it understandably could not forego that avenue for relief if this suit failed. The state trial court has denied the injunction and NOPSI has appealed to the state intermediate appellate court, seeking expedited consideration. The state trial court record was not scheduled to be filed with the state appellate court until July 15, 1988, however, and that appellate court has therefore deemed the motion for expedited appeal premature.)

[14]28 U.S.C. § 1342 (1982).
[15]319 U.S. 315, 63 S.Ct. 1098 (1943).
[16]798 F.2d at 862.

The federal district court also observed, however, that it was not ready to assume that many, if any, purchasers could be found today to buy the power allocated to NOPSI. It continued:

> Indeed, this court is somewhat mystified by the Council's logic in arriving at the $135 million disallowance in the Rate Order. In the Rate Order, the Council simply concluded that since [NOPSI's President] said so, savings were actually possible. Then, the Council seemingly pulled from thin air a figure of 8% for the prudence disallowance. However, the Council, and in this case, everyone else knows that the 8% figure was not pulled from thin air but represents the difference between FERC's 17% allocation and what NOPSI consistently claims as its relative share in the MSU system, i.e. 9%. Thus, the disallowed costs bear no apparent relationship to the savings NOPSI is said to have foregone. Must not the savings posited as the reason for the disallowance be at least possible in an actual economic market? Furthermore, must not the ultimate disallowance bear some rational relationship to the possible savings which support that disallowance? These questions must be resolved on another day in another court.

The district court did not reach the other factual issues. We must assume that the court thought it should abstain even if NOPSI were able to prove, as it alleges, with some apparent evidentiary support, that what was not clear when *NOPSI I* was decided is now clear: the Rate Order results in "trapping" FERC allocated costs in violation of federal law; important facts have therefore changed since the decision in *NOPSI I;* the Rate Order itself demonstrates that the disallowance of rate increases was based on factors that the state could not legally consider; and consequently the Order "is beyond the Council's retail ratemaking authority and violates federal law."

II.

If the jurisdiction of federal courts over this dispute is made exclusive by the Federal Power Act, the district court should not have abstained. The Act grants federal courts exclusive

jurisdiction over all suits brought to enforce any "duty created by . . . any rule, regulation, or order" promulgated under the Act.[17] NOPSI's thesis is that the Act creates a duty on the part of the Council to recognize for retail ratemaking purposes NOPSI's FERC allocation, net of cost savings in other areas, and that the duty must be enforced by and can be enforced only in federal court.

In *Nantahala,* the Supreme Court expressly held that the filed rate doctrine requires local utility regulators to "allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price."[18] The Court further stated, "[o]nce FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable."[19] Correspondingly, in *NOPSI II* this court stated:

> [O]nce the FERC has allocated wholesale power, a state regulatory body may not refuse to recognize that allocation. The state may not, for example, find the allocation unreasonable and "trap" any extra costs by refusing to allow the utility to pass those costs on to consumers.[20]

After oral argument had been heard in this case, the Supreme Court rendered its opinion in Mississippi Power & Light Company v. Mississippi ex rel Moore, a case which, like *Nantahala,* came to the Court by direct appeal.[21] In *Mississippi Power,* the Court held that the FERC proceedings preempted a prudence

[17] 16 U.S.C. § 825p (1982) provides in pertinent part:

> The District Courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules, regulations, and orders thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of this chapter or any rule, regulation, or order thereunder.

[18] 476 U.S. at ____, 106 S.Ct. at 2356.

[19] *Id.* at ____, 106 S.Ct. at 2357.

[20] 833 F.2d at 586 (citations omitted).

[21] ____ U.S. ____, ____ S.Ct. ____, No. 86-1970 (June 24, 1988.)

inquiry by a state regulatory commission. The *Mississippi Power* prudence inquiry differed somewhat from the City Council's inquiry: it was directed to the prudence of entering into the Sales Agreement and the Grand Gulf project, while the Council's order is directed at NOPSI's asserted imprudence in failing to resell the power it had agreed to, and is now bound by the FERC order to, buy. Nonetheless, the language of the opinion seems to foreclose the latter kind of prudence inquiry as well. Thus, for example, the Court stated:

> States may not alter FERC-ordered allocations of power by substituting their own determinations of what would be just and fair. FERC-mandated allocations of power are binding on the States, and States must treat those allocations as fair and reasonable when determining retail rates. . . .
>
> States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates. "The filed rate doctrine ensures that sellers of wholesale power governed by FERC can recover the costs incurred by their payment of just and reasonable FERC-set rates. When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate. . . . Such a 'trapping' of costs is prohibited."[22]
>
> . . . Thus we conclude that the Supremacy Clause compels the [state regulatory commission] to permit MP&L to recover as a reasonable operating expense costs incurred as the result of paying a FERC-determined wholesale rate for a FERC-mandated allocation of power.
>
> . . . [I]t might well be unreasonable for a utility to purchase unnecessary quantities of high cost power, even at FERC-approved rates, if it had the legal right to refuse to buy that power. But if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L

[22] *Id.* at ____, ____ S.Ct. ____ at ____ (quoting Nantahala Power & Light Co. v. Thornburg, 476 U.S. at 970, 106 S.Ct. at 2359).

to procure the particular quantity of high-priced Grand Gulf power that FERC has ordered it to pay for. Just as Nantahala had no legal right to obtain any more low cost TVA power than the amount allocated by FERC, it is equally clear that MP&L may not pay for less Grand Gulf power than the amount allocated by FERC.

. . . .

. . . Thus FERC's order specificially bars a state regulatory agency from evaluating the prudence of Grand Gulf "in light of local conditions."[23]

In *NOPSI I*, this court held that it does not follow from *Nantahala* that the duty imposed on a state regulatory body to recognize FERC allocations and rates must be enforced by a federal court. While the Federal Power Act did grant FERC exclusive authority to regulate interstate transmission and sale at wholesale of electric energy, it reserved to the states regulatory jurisdiction over generation facilities and the intrastate transmission of electric energy.[24] This dichotomy of supervision made it foreseeable to Congress that what has happened in Louisiana might indeed come to pass: conflicts might arise over a state's attempt to regulate matters reserved to the FERC. The filed rate doctrine was developed to ensure the supremacy of FERC's orders in state as well as federal proceedings.[25] It does not establish federal exclusivity.

NOPSI I therefore rejected the claim that federal jurisdiction is exclusive:

> The existence of [a] "bright line" [between federal and state jurisdiction] colors the way we view a preemption claim involving the Federal Power Act. NOPSI has attempted to depict the situation before us as one in which the Council is stepping into the realm of *wholesale* rate making, a field

[23] *Id.* at ___, ___ S.Ct. at ___.

[24] 16 U.S.C. §§ 824(b) (1982); *see also NOPSI I*, 798 F.2d at 860.

[25] *See Nantahala*, 476 U.S. at ___, 106 S.Ct. at 2355.

> under the exclusive jurisdiction of FERC. NOPSI focuses on the disruption of a *federal* scheme. Yet federal court intervention here may constitute a disruption of a *state* regulatory scheme, for *retail* rate making is clearly a field left to the jurisdiction of the states. . . . *Nantahala* recognizes that retail rates need not necessarily be increased to reflect the corresponding increase in wholesale rates set by FERC. Instead, local councils are permitted the autonomy preserved to them by the Federal Power Act and can consider cost savings in other areas relevant to the setting of retail rates.[26]

Thus *NOPSI I* holds that while state regulators are bound by FERC decisions and the filed rates doctrine, the doctrine may be invoked in state proceedings and the existence of a filed rate issue does not dictate federal court jurisdiction. As the opinion in *NOPSI I* acknowledges,[27] two other circuits have reached the same conclusion, deciding to abstain,[28] while three other courts have refused to do so.[29]

III.

The Supreme Court has held that, in three different situations, a federal court with jurisdiction over a matter that also lies within the jurisdiction of a state court or agency should abstain from exercising its jurisdiction.[30] When a case involves unsettled

[26] *NOPSI I*, 798 F.2d at 860-61 (emphasis in original).

[27] *Id.* at 862 n.1.

[28] *See* Aluminum Co. of America v. Utilities Comm'n, 713 F.2d 1024 (4th Cir. 1983), *cert. denied*, 465 U.S. 1052, 104 S.Ct. 1326 (1984); American Elec. Power Co. v. Kentucky Pub. Serv. Comm'n, 787 F.2d 588 (6th Cir. 1986); *but see* Appalachian Power Co. v. Public Serv. Comm'n of West Virginia, 770 F.2d 159 (4th Cir. 1985), *aff'g without opinion* 614 F. Supp. 64 (S.D. W.Va. 1985).

[29] *See* Kentucky West Virginia Gas Co. v. Pennsylvania Pub. Util. Comm'n, 791 F.2d 1111 (3d Cir. 1986); Middle South Energy, Inc. v. Arkansas Pub. Serv. Comm'n, 772 F.2d 404 (8th Cir. 1985), *cert. denied*, ___ U.S. ___, 106 S.Ct. 884 (1986); International Bhd. of Elec. Workers, Local Union No. 1245 v. Pub. Serv. Comm'n, 614 F.2d 206, 212 n.1 (9th Cir. 1980).

[30] Colorado River Water Conservation Dist. v. United States, 424 U.S. 800, 813-17, 96 S.Ct. 1236, 1244-46 (1976).

questions of state law, the resolution of which may make it unnecessary to decide a federal constitutional question, the federal court should abstain pending resolution of the state-law questions by a state court,[31] a doctrine known as *Pullman* abstention after the Supreme Court case that first invoked it. A federal court should also abstain from deciding a case to avoid needless conflict with a state's administration of its own affairs, a rule applied in Burford v. Sun Oil Co.[32] In Younger v. Harris,[33] the Supreme Court ruled that a federal court should abstain from deciding actions brought in an equitable setting when considerations of comity and federalism, relating both to a state's interest in conducting a pending state court proceeding and to the state's ability to consider federal constitutional claims in that setting, so dictate.

In Colorado River Water Conservation District v. United States,[34] the Supreme Court approved dismissal of a federal court suit on the basis of "considerations of '[w]ise judicial administration, giving regard to conservation of judicial resources and comprehensive disposition of litigation,' "[35] although abstention

[31]Railroad Comm'n v. Pullman Co., 312 U.S. 496, 61 S.Ct. 643, 85 L.Ed. 971 (1941); *see also Colorado River*, 424 U.S. at 814, 96 S.Ct. at 1244; *see generally* 17 C. Wright, A. Miller & E. Cooper, Federal Practice & Procedure §§ 4241-42 (1978 & Supp. 1987).

[32]Burford v. Sun Oil Co., 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943); *see also Colorado River,* 424 U.S. at 814-15, 96 S.Ct. at 1244-45; County of Allegheny v. Frank Mashuda Co., 360 U.S. 185, 189, 79 S.Ct. 1060, 1063, 3 L.Ed.2d 1163 (1959); *see generally* Wright, Miller & Cooper, *supra* note 31, at §§ 4241, 4244.

[33]*See* Younger v. Harris, 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971); *see also* Ohio Bureau of Employment Servs. v. Hodory, 431 U.S. 471, 477, 97 S.Ct. 1898, 1902-03, 52 L.Ed.2d 513 (1977); *Colorado River,* 424 U.S. at 816, 96 S.Ct. at 1245-46; *see generally* Wright, Miller & Cooper, *supra* note 31, at §§ 4241, 4251-55.

[34]424 U.S. 800, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976).

[35]*Id.* at 817, 96 S.Ct. at 1246 (quoting Kerotest Mfg. Co. v. C-O-Two Fire Equip. Co., 342 U.S. 180, 183, 72 S.Ct. 219, 221, 96 L.Ed. 200, 203 (1952)).

would not have been appropriate under previously recognized abstention doctrines. In *Colorado River,* the Court observed that "the circumstances permitting the dismissal of a federal suit due to the presence of a concurrent state proceeding for reasons of wise judicial administration are considerably more limited than the circumstances appropriate for abstention."[36]

In Evanston Insurance Co. v. Jimco, Inc.,[37] on which NOPSI relies, we considered the application of the *Colorado River* rule because judicial proceedings were pending in both state and federal court and only considerations of judicial administration were involved. In *NOPSI I,* however, the district court based its decision to abstain primarily on the *Burford* rule, seeking to avoid intrusion into the state administration of a complex state regulatory system. The *Evanston Insurance* decision is therefore not applicable here.

Turning to the appropriateness of *Burford* abstention in this case, we do not write on a clean slate. While the district court's decision to abstain is reviewable, we are not to decide whether we would write the same opinion if we were sitting as a trial court, but whether the district court abused its discretion in reaching its decision, a question whose answer requires at least some deference to the district court's views. In addition, we are bound by the text and the implicit philosophy of *NOPSI I.* In *NOPSI I* this court affirmed the district court's decision to abstain because exercising federal jurisdiction would interfere with the state regulatory system:

> [T]he regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise. The regulatory system is complex. In addition, the Louisiana state courts are fully able to address NOPSI's complaints about Council actions: appeals from Council orders are to be filed with the Civil District

[36]*Id.* at 818, 96 S.Ct. at 1246.

[37] No. 87-3605 (5th Cir. May 17, 1988).

> Court for the Parish of Orleans . . . . Nor would federal abstention foreclose the United States Supreme Court from entertaining NOPSI's preemption claim should it wind its way up through the state courts, as is demonstrated by the path of the recent *Nantahala* case.[38]

The opinion continued, "Although we do not intimate that abstention in the face of a preemption claim under the Federal Power Act may never constitute an abuse of discretion, abstention should perhaps more often obtain in cases presenting a question of preemption under the Federal Power Act than would be so in cases presenting other types of federal preemption claims."[39]

The *NOPSI I* opinion also stated, "[M]oreover, on these facts, abstention seems appropriate under the doctrine of Younger v. Harris."[40] *Younger* would justify abstention because the Council proceedings constituted an ongoing state judicial proceeding, involving important state interests, and in that proceeding NOPSI had an adequate opportunity to litigate its federal claims. The opinion noted, in connection with the appropriateness of *Younger* abstention, the absence of "bad faith, harrassment, or other exceptional circumstances."[41] *NOPSI I* thus recognized a second basis for its affirmance of the district court's decision to abstain.

The court in *NOPSI I* did not partially reverse the district court's decision to abstain by requiring it to decide whether the Council should be enjoined to allow NOPSI to pass on all of the costs allocated by FERC while affirming that decision only insofar as it abstained from interfering with the City Council's retail ratemaking functions. It decided instead to abstain totally. When a federal court decides to abstain, it does not decide to keep federal hands off only so long as the state agency behaves as the

[38] 789 F.2d at 862.

[39] *Id.* at 861.

[40] *Id.* at 863.

[41] *Id.* at 864; *see* Middlesex County Ethics Comm. v. Garden State Bar Ass'n, 457 U.S. 423, 435, 102 S.Ct. 2515, 2523 (1982).

court thinks proper. Instead, it decides not to interfere at all, leaving to the state agency, the state courts, and, ultimately, the United States Supreme Court, the interpretation of both state and federal law and the ultimate protection of the federal constitution.

While more facts are now known, NOPSI foresaw the issues these facts have raised. The first *NOPSI* opinion outlined the issues NOPSI raised at that time:[42]

> NOPSI first raised a statutorily-based preemption claim. NOPSI alleged that the Council, in setting NOPSI's retail rates, had refused to recognize the expenses NOPSI was required to pay by FERC order: the Council's rate freeze assumed in essence that the FERC opinion had never been issued, and that NOPSI was obtaining no Grant Gulf Unit I power. The refusal to recognize FERC-determined wholesale costs for retail rate-making purposes frustrated the FERC order allocating costs, thereby violating FERC's exclusive authority to regulate wholesale energy under the Federal Power Act, 16 U.S.C. §§ 824-824k. NOPSI also claimed that the Council's refusal to honor the FERC order constituted an impermissible burden on interstate commerce, as NOPSI would be rendered insolvent; the FERC order allocating costs among companies in several states would be frustrated; financial agreements among the MSU companies would be harmed; the operation of Grand Gulf Unit One would be threatened; and the viability of the interstate integrated electric system would be seriously undermined.

The opinion in *NOPSI I* noted that the challenge was only to "anticipated state agency action,"[43] but the issues before the court now are the same as those presented in that case. The only differences are that the administrative proceeding before the City Council has been completed and the Supreme Court has decided *Mississippi Power & Light*, a case in which abstention was not an

[42] 782 F.2d at 1238.

[43] 798 F.2d at 864 n.3.

issue. The Council proceeding, followed by the opportunity for state review, thus constitutes an ongoing judicial proceeding.[44]

In *NOPSI II*, NOPSI sought an injunction to prevent the Council from trapping the FERC-allocated Grand Gulf costs. Addressing the question whether the issue was ripe, the Council argued that the court should wait to see what action the Council took. Until then, the issue was not ready for court action. Now the Council has acted. It retreats to a second line of defense: the issue is ripe but the court should abstain. The Council's arguments in the successive cases appear to involve a certain amount of adroitness, but the opinion in *NOPSI I* nonetheless requires us to uphold the district court's decision to abstain.

IV.

The decision to abstain from intervening at an earlier stage and not to restrict the Council's action to purely retail ratemaking concerns, as may have been permitted by *Nantahala*, allowed the Council to proceed with a hearing at least ostensibly addressed to retail ratemaking. Abstention necessarily forces the state courts to consider the application of the Supreme Court decisions and will eventually present the Supreme Court itself, already burdened by a massive docket, with a case that may involve only the application of principles it has now clearly articulated. Only that Court can resolve the conflict among the federal courts about the appropriateness of abstention in this situation, and it has not yet spoken. This court has. In so doing, this circuit has made a rule for this case. NOPSI must seek relief elsewhere.

For these reasons, the judgment is affirmed.

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[44]*See* Ohio Civil Rights Comm'n v. Dayton Christian Schools, Inc., ___ U.S. ___, ___, 106 S.Ct. 2718, 2723 (1986); Middlesex County Ethics Comm. v. Garden State Bar Ass'n, 457 U.S. at 432–34, 102 S.Ct. at 2521–22.

DISTRICT COURT OPINION AND ORDER [MARCH 10, 1988]

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF LOUISIANA

NEW ORLEANS PUBLIC SERVICE, INC., *VERSUS* THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.	CIVIL ACTION NO. 88-559 SECTION "D" (2)

OPINION AND ORDER

For the third time in as many years these parties are before this court embroiled in a dispute over the Defendants', the Council of the City of New Orleans ("The Council"), regulatory actions concerning New Orleans Public Service, Inc. ("NOPSI") and Grand Gulf I, a nuclear power plant located near Port Gibson, Mississippi. NOPSI, a subsidiary of Middle South Utilities, Inc. ("MSU"), provides electric service to most of the City of New Orleans. NOPSI also engages in the production, wholesale interstate purchase, wholesale interstate sale and retail sale of electric power. With the exception of a brief period, the Council has exercised local regulatory jurisdiction over NOPSI since 1922.

Pursuant to an "Opinion and Order Setting Just Reasonable and Non-Discriminatory Rates," 31 F.E.R.C. (CCH) para. 61, 305 (June 13, 1985) ("Opinion No. 234"), the Federal Energy Regulatory Commission ("FERC"), allocated the costs of Grand Gulf I among four MSU subsidiaries: Arkansas Power & Light Co.; Louisiana Power & Light Co.; Mississippi Power & Light Co.; and NOPSI. NOPSI's share of Grand Gulf I costs under Opinion No. 234 is 17%. In July 1985, NOPSI began paying its 17% of the costs, approximately $13 million a month, to System

Energy Resources, Inc. ("SERI") (formerly Middle South Energy, Inc. ("MSE")), another MSU subsidiary and principal owner of Grand Gulf I.

NOPSI's third trip to this court, like its second,[1] arises out of the Council's investigation of NOPSI's prudence with respect to investment, oversight, and participation in the Grand Gulf I project. After the FERC issued Opinion No. 234, NOPSI initiated a retail rate making proceeding before the Council by requesting permission to increase its electric rates to recover expenses associated with Grand Gulf I. After several hearings and extensive federal court litigation (i.e., *NOPSI I*), on March 20, 1986 the Council adopted Resolution No. R-86-112, which accepted, subject to certain modifications, a settlement proposal advanced by NOPSI with respect to its application for permanent rate relief. The settlement required that NOPSI's shareholders absorb approximately $51.2 million of Grand Gulf I costs and provided that remaining costs would be phased into retail electric rates over a period of approximately twelve years, with annual rate increases limited to approximately 6%. The settlement expressly reserved to the Council the right to conduct an investigation of NOPSI's prudence with respect to Grand Gulf I.

On October 17, 1985, the Council adopted Resolution No. R-85-636 by which it initiated its inquiry into the prudence of NOPSI's involvement in Grand Gulf I. The prudence inquiry proceeded in three phases. The first, dealing primarily with

[1] *See, New Orleans Public Service, Inc. v. City of New Orleans,* No. 85-5273 (E.D. La. December 19, 1986), *aff'd,* 833 F.2d 583 (5th Cir. 1987) ("NOPSI II"). In *NOPSI II,* NOPSI sought an order preventing the Council from impermissibly "trapping" FERC allocated Grand Gulf I costs as a result of the Council's prudence inquiry. This court dismissed the suit in *NOPSI II* on grounds of ripeness and abstention. For a history of NOPSI's first trip to this court see the Fifth Circuit Opinion in *New Orleans Public Service, Inc. v. City of New Orleans,* 782 F.2d 1236, *withdrawn in part,* 798 F.2d 858 (5th Cir. 1986), *cert. denied,* 107 S. Ct. 1910 (U.S. 1987) ("NOPSI I").

substantive questions bearing on prudence, involved evidentiary hearings in April 1986. In May 1986, the Council set dates for additional discovery, testimony and hearings on the second phase which involved the economic impact of possible remedies if imprudence were ultimately found. Hearings on this second phase were held in October 1986. The passage of the Tax Reform Act of 1986 during the hearings required a material reconsideration of economic issues and a third and final hearing was held for that purpose in February 1987.

On February 4, 1988, by Resolution No. R-88-14, the Council formally concluded its prudence investigation by adopting its "Determinations and Order Regarding the Prudence of the Management of New Orleans Public Service, Inc. with respect to Grand Gulf I" ("the Rate Order"). The Rate Order requires a one-time disallowance and write-off by NOPSI of a sum equal to $135 million in NOPSI's deferred Grand Gulf I expenses and a reduction in planned rate increases commencing April 9, 1988 to reflect the $135 million disallowance. The Rate Order does not ostensibly question NOPSI's FERC-allocated Grand Gulf I costs and it expressly provides that the disallowance is *not* based on the determination that NOPSI was imprudent in committing to an indeterminate responsibility to pay for Grand Gulf I. Rate Order at 9-10. Rather, the Council determined that as a result of NOPSI's deficient and uncritical oversight of the Grand Gulf I project and its failure to realistically assess its heightened risk exposure in the wake of the Three-Mile Island incident, NOPSI imprudently failed to reduce the risk of its Grand Gulf commitment in 1979 and 1980 by selling a portion of its share of the nuclear power off-system and further did not even attempt to ascertain whether off-system sales could be accomplished notwithstanding its President's assurances to the Council that such sales were possible. Rate Order at 9-13.

In this suit, NOPSI seeks preliminary and permanent injunctive and declaratory relief from the Council's Rate Order. NOPSI alleges that the Rate Order is inconsistent with and preempted

by federal law, that this court is vested with exclusive jurisdiction by virtue of the Federal Power Act, 16 U.S.C. § 825p, and that if the Rate Order is allowed to stand NOPSI will suffer irreparable harm. The Council has moved to dismiss the Complaint on alternative grounds that the court is without jurisdiction to issue an injunction pursuant to the Johnson Act, 28 U.S.C. § 1342, that the court should abstain from exercising jurisdiction, and that the Complaint fails to state a claim upon which relief can be granted. Both NOPSI's Motion for a Preliminary Injunction and the Council's Motion to Dismiss are now before the court.

At the outset, it is important to note that as the Council has made a "factual attack" upon this court's subject matter jurisdiction, the court is "free to weigh the evidence and satisfy itself as to the existence of its power to hear the case." *Evans v. Tubbe,* 657 F.2d 661, 663 (5th Cir. 1981). Moreover, it is encumbent upon NOPSI to prove that jurisdiction does in fact exist. *Menchaca v. Chrylser Credit Corp.,* 613 F.2d 507, 511 (5th Cir.), *cert. denied,* 449 U.S. 953, 101 S. Ct. 358, 66 L. Ed. 2d 217 (1980).

Having considered the Complaint, the Rate Order, the depositions and affidavits filed herein, the memoranda and attachments of counsel and the applicable law, and for reasons which follow, the court is of the opinion that: 1) The Johnson Act does not preclude jurisdiction in this case; 2) This court does not have exclusive jurisdiction under the Federal Power Act; and, 3) This court should abstain from exercising jurisdiction over the claims presented by NOPSI.

I.

In *NOPSI I*[2] this court held that the Johnson Act[3] precluded the court from enjoining the Council's exercise of regulatory

[2]*New Orleans Public Service, Inc. v. The City of New Orleans,* Civil Action No. 85-3398 (E.D. La. Sept. 16, 1985) *(NOPSI I* Slip Op.).

[3]The Johnson Act, 28 U.S.C. § 1342, provides:

The district courts shall not enjoin, suspend or restrain the operation of, or compliance with, any order affecting rates chargeable by a public

(Footnote continued on next page.)

jurisdiction over NOPSI. Were this court not bound by subsequent Fifth Circuit precedent in *NOPSI I*,[4] this court would again, for essentially the same reasons, find that the four Johnson Act elements are present in this case. However, this court is not free to ignore the Fifth Circuit's pronouncement in NOPSI I. Accordingly, this court is constrained to hold that the Johnson Act does not preclude jurisdiction to enter the injunctive relief NOPSI seeks.

II.

Though *NOPSI I* supports the existence of subject matter jurisdiction in this case, the parties before the court and the issues presented are virtually identical to those in *NOPSI I* and *NOPSI II*, and this court is still convinced that abstention is the proper course under these circumstances. As this court explained in *NOPSI I*, abstention embodies the well-established principle that under the rule of comity in cases dealing with state laws, rules or policy decisions, equitable considerations will require a federal court to stay its hand. *NOPSI I*, Slip Op. at 13; *General Investment Service Corp. v. Wichita Water Co.*, 236 F.2d 464, 468 (10th Cir. 1956). Abstention is particularly appropriate where the exercise of federal court jurisdiction would disrupt a state's administrative process or interfere with a state's ability to formulate policies in complex matters of local concern. *Burford v. Sun Oil Co.*, 319 U.S. 315, 63 S. Ct. 1098, 87 L. Ed. 2d 1424 (1943). *"Burford"*

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utility and made by a State administrative agency or a rate-making body of a State political subdivision, where:

(1) Jurisdiction is based solely on diversity of citizenship or repugnance of the order to the Federal Constitution; and,

(2) The order does not interfere with interstate commerce; and,

(3) The order has been made after reasonable notice and hearing; and,

(4) A plain, speedy and efficient remedy may be had in the courts of such State.

[4]*See* Note 1 *supra*.

abstention is appropriate where a state's regulatory scheme touches complex matters of paramount local concern which require administrative expertise and the state's regulatory scheme provides prompt judicial review in which questions of conflict with federal law can be effectively addressed. *NOPSI I*, 798 F.2d 858, 861–62.

As both this court and the Fifth Circuit have previously held, "the regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise." *Id.* at 862. The fact that the Council has completed its prudence inquiry does not end the need for state administrative involvement. One of the driving concerns of *Burford* abstention is for the state's ability to formulate local administrative policy consistent with federal law without undue interference from federal courts. Exercise of jurisdiction at this stage would preclude the state court from assessing and formulating state policy. Finally, the Council's Rate Order is subject to review in Louisiana state court.[5] Indeed, the Council and other parties which had intervened in the prudence inquiry have filed suit in the Civil District Court for the Parish of Orleans in connection with the Council's Rate Order.[6] NOPSI has likewise filed an appeal in Civil District Court to preserve its rights pending our decision in this case.[7] Though NOPSI's desire to litigate issues of federal law in a federal forum is understandable, this court is confident that Louisiana's state courts are more than competent to handle any federal questions presented. Unlike NOPSI, this

[5]*NOPSI I*, 798 F.2d at 862.

[6]Both of these suits were removed by NOPSI to this court. Motions to Remand are currently pending in these cases. *Lambert Boissiere, Jr., et al. v. James M. Cain, et al.* Civil Action No. 88-581; *Alliance for Affordable Energy, Inc., et al. v. The Council of the City of New Orleans, et al.*, Civil Action No. 88-816.

[7]*New Orleans Public Service, Inc. v. The Council of the City of New Orleans, et al.*, No. 88-4511 (Civil District Court for the Parish of Orleans, March 7, 1988).

court does not believe that the Louisiana courts will dispose of federal issues "from a biased perspective." The Louisiana courts are bound to enforce federal law and this court can only assume that they will do so. Therfore, this court is convinced that *Burford* abstention is appropriate in this case.[8]

NOPSI argues that the FERC Opinion and Supreme Court precedent impose a duty on the Council to recognize and "pass through" FERC-allocated costs except where those costs are offset by cost savings in other areas unrelated to the FERC-allocated costs. This duty, NOPSI contends, is a duty created by a FERC opinion, and as such, is the subject of exclusive federal jurisdiction under the Federal Power Act, 16 U.S.C. § 825p. Thus, the argument goes, abstention is not appropriate since NOPSI cannot litigate in state court an issue reserved exclusively to federal court.

Central to NOPSI's argument is the Supreme Court opinion in *Nantahalla Power & Light Co. v. Thornburg*, ___ U.S. ___, 106 S. Ct. 2349, 90 L. Ed. 2d 943 (1986). In *Nantahalla* the FERC had allocated the available sources of low-cost power between two utilities located in different states. This necessarily meant that the utility receiving the lower allocation of low-cost power, Nantahalla Power and Light Co. ("NP&L"), would have to purchase greater amounts of higher-cost power in order to meet retail demand and therefore would incur a higher average cost per unit of power at the wholesale level. The North Carolina Utilities Commission ("NCUC") simply substituted its own allocation of low-cost power in place of the FERC's for purposes of setting retail rates. Thus, under the NCUC's Order, NP&L was forced to calculate its retail rates as if it received more of the low-cost power than actually allocated by the FERC.

[8]This court also finds that *Younger* abstention is applicable in these circumstances. *See NOPSI I*, 798 F.2d 858, 863–64. The appellate review of the Council's Order constitutes an ongoing judicial proceeding implicating important state interests, and in that proceeding NOPSI will have an adequate opportunity to raise its federal claims. *Id.* at 864.

The Supreme Court held that on the facts presented, the filed rate doctrine, a principle rooted in the Supremacy Clause, required the NCUC to pass through in retail rates the wholesale costs based on the FERC's allocation of low-cost power. The court noted that while the NCUC was required to treat FERC-allocated costs as a "reasonably incurred operating expense for the purposes of setting an appropriate retail rate,"[9] the FERC allocation need not be passed through entirely where, as an incident of traditional ratemaking authority, the local regulator found cost savings in other areas to offset the FERC-allocated wholesale costs. The Court went on to conclude:

> But in this case, there is no finding or indication that [NP&L's] costs of obtaining purchased power have decreased, or that other costs of operation have declined dramatically. There is only NCUC's assertion that [NP&L] should have obtained more of the low-cost FERC regulated power than [NP&L] is in fact entitled to claim under FERC's order. Such a rationale runs directly counter to FERC's order . . . .

Nantahalla, 106 S. Ct. at 2358.

NOPSI reads *Nantahalla* expansively to require that except for offsets of cost savings actually experienced in areas completely unrelated to FERC-allocated costs, the Council must pass through all FERC-allocated wholesale costs in setting the retail rate NOPSI may charge its customers. This court does not read *Nantahalla* so expansively. The holding in *Nantahalla* must be read in the context of the court's analysis of underlying cases and in light of the facts presented to the Court.

After a careful reading, this court does not believe that the *Nantahalla* Court intended to set out an exhaustive catalog of permissible retail deviations from FERC allocated wholesale costs. Rather, the Court simply responded to the North Carolina

[9]*Nantahalla*, 106 S. Ct. at 2357 (quoting *State ex rel Utilities Commission*, 313 N.C. 614, 692, 332 S.E.2d 397, 443 (1985)).

Supreme Court's "oversimplification" of the *Narragansett*[10] line of cases and concluded that the facts present in NP&L were distinguishable from those in the *Narragansett* line. *Nantahalla*'s admonition that costs incurred by complying with FERC ordered energy allocations are to be passed to the consumer cannot be considered in splendid isolation. *Nantahalla* did not in any manner involve a prudency issue. In *Nantahalla* the NCUC simply refused to recognize the FERC's allocation without any consideration of managerial prudence or other cost savings available. In this case, the Council has explicitly recognized the FERC allocated costs, but it has determined that given those costs, NOPSI's management should have reduced the impact of those costs by selling some of its Grand Gulf power "off system" as James Cain, NOPSI's President, said NOPSI could do. Thus, the Council is not asserting that NOPSI should have obtained less Grand Gulf, FERC-regulated power than ordered by the FERC. In essence, the Council faults NOPSI not for buying a 'pig in a poke' but for failing to find a sucker to buy it when the faux-pas became apparent.[11] Though nuclear power may have seemed a wise option

[10]*Narragansett Electric Co. v. Burke,* 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied,* 435 U.S. 972, 98 S. Ct. 1614, 56 L. Ed. 2d 63 (1978); *Public Service Co. of Colorado v. Public Utilities Commission,* 644 P.2d 933 (Colo. 1982). In both cases the courts held that the regulatory authority need not automatically pass through in retail rates an increase in FERC-approved wholesale rates where the utility company has experienced "savings" in other areas which might offset the increased price . . . ." *Narragansett,* 119 R.I. at 568, 381 A.2d at 1363; *Public Service Co.,* 644 P.2d at 941.

[11]P.T. Barnum once said of suckers: "There's one born every minute." This court, however, is not ready to assume there are many, if any, such suckers purchasing electricity in the wholesale market today. Indeed, this court is somewhat mystified by the Council's logic in arriving at the $135 million disallowance in the Rate Order. In the Rate Order, the Council simply concluded that since James Cain said so, savings were actually possible. Then, the Council seemingly pulled from thin air a figure of 8% for the prudence disallowance. However, the Council, and in this case, everyone else knows that the 8% figure was

(Footnote continued on next page.)

when MSU and NOPSI first committed to Grand Gulf in the 1970's, recent events have proven it otherwise. So, while *Nantahalla* does foreclose the Council's review of the 17% mandatory allocation of FERC, it does not foreclose an inquiry into the prudency of NOPSI's acts or omissions in the face of the anticipated and unwelcome FERC allocation. These are the inquiries which the Council's Rate Order ostensibly addresses.

But even if this court accepted NOPSI's reading of *Nantahalla*, that opinion does not create a duty under the Federal Power Act, 16 U.S.C. § 825p. NOPSI's argument cannot be squared with the structure of the Federal Power Act ("FPA"), the Fifth Circuit's revised opinion in *NOPSI I*, or the language of Nantahalla itself. As this court and others have explained, the FPA delegated to the FERC exclusive authority to regulate interstate transmission and sale at wholesale of electric energy while reserving to the states regulatory jurisdiction over generation facilities and the intrastate transmission of electric energy. *NOPSI I,* 798 F.2d at 860. That conflicts might arise over a state's attempt to regulate matters reserved to the FERC was foreseeable. Courts therefore developed the filed rate doctrine to ensure the supremacy of the FERC's orders in *state* as well as federal proceedings. To hold that *Nantahalla*, which is based explicitly on the filed rate doctrine and preemption, creates a duty enforceable under § 825p flies in the face of numerous state court decisions, including *Nantahalla,* in which state courts have addressed federal issues of *preemption*. Were NOPSI's position correct state courts which routinely address preemption issues in utility rate cases would be

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not pulled from thin air but represents the difference between FERC's 17% allocation and what NOPSI consistently claims as its relative share in the MSU system, i.e. 9%. Thus, the disallowed costs bear no apparent relationship to the savings NOPSI is said to have foregone. Must not the "savings" posited as the reason for the disallowance be at least possible in an actual economic market? Furthermore, must not the ultimate disallowance bear some rational relationship to the possible savings which support that disallowance? These questions must be resolved on another day in another court.

without jurisdiction. Such a position is untenable. In *NOPSI I*, the Fifth Circuit implicitly rejected this proposition. This court does so explicitly. The issues reserved to the federal courts by 16 U.S.C. § 825p are those directly related to the FPA, the FERC's orders thereunder, and the obligations imposed by those orders.[12] This case simply presents no such issue.

NOPSI further argues that abstention is not appropriate since the Council's Rate Order is entirely preempted as a matter of federal law. This argument fails on two points: As discussed above, *Nantahalla* does not support preemption of the Council's Rate Order. But even if *Nantahalla* could be read to support preemption here, it does not preclude abstention where there is no direct facial conflict with the FERC Order or where the government has not preempted the entire field. *Aluminum Company of America v. Utilities Commission of North Carolina,* 713 F.2d 1024 (4th Cir. 1983), *cert. denied,* 465 U.S. 1052 (1984)("*Alcoa*"). Where the circumstances are otherwise appropriate for *Burford* abstention, this court need not examine the indirect effects of the Rate Order on the FERC allocation as a prerequisite to abstention. *Id.*

The Rate Order, on its face, sets only retail rates; it does not attempt to order that NOPSI pay SERI any amount different from that ordered by the FERC. Thus, there is no facial conflict with FERC Opinion No. 234. Furthermore, the division of federal and state authority in the Federal Power Act makes it clear that the government has not entirely preempted state regulation of retail sales of electricity. Since the circumstances are otherwise appropriate for *Burford* abstention, this court need not and will

[12]For example, the Federal Power Act imposes duties upon utilities, among others, to apply to the FERC for approval before disposition of certain property, § 825b; to refrain from granting undue preferences and unreasonable differences in rates, § 824d(b); and to keep certain records, § 825. Similarly, FERC Opinion 234 imposes on NOPSI the duty to pay SERI a certain percentage of the costs of Grand Gulf I. Any suit to enforce these duties would be subject to exclusive federal jurisdiction.

not look further. Despite NOPSI's persistent invocation of federal jurisdiction in *NOPSI I, NOPSI II* and here, in what is sure to become *NOPSI III,* the court remains convinced that abstention is the proper course under these circumstances. Like the path followed in *Nantahalla,* NOPSI's plea for relief should be litigated first in the state court forum. Either party may then seek United States Supreme Court review of the final determination by the Louisiana state courts. Accordingly;

IT IS ORDERED that the Council's Motion to Dismiss be and is hereby GRANTED and NOPSI's Complaint for Preliminary and Permanent Injunctive and Declaratory Relief is hereby DISMISSED without prejudice.

New Orleans, Louisiana, this 10th day of March, 1988.

UNITED STATES DISTRICT JUDGE

COURT OF APPEALS JUDGMENT
[JULY 28, 1988]

United States Court of Appeals
FOR THE FIFTH CIRCUIT

No. 88-3194

D.C. Docket No. CA-88-559-D

NEW ORLEANS PUBLIC SERVICE, INC.,

Plaintiff-Appellant,

versus

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.,

Defendants-Appellees.

Appeal from the United States District Court for the Eastern District of Louisiana

Before RUBIN, GARZA, and JONES, Circuit Judges.

JUDGMENT

This cause came on to be heard on the record on appeal and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the District Court in this cause is affirmed.

IT IS FURTHER ORDERED that plaintiff-appellant pay to defendants-appellees the costs on appeal, to be taxed by the Clerk of this Court.

July 28, 1988

ISSUED AS MANDATE: August 19, 1988

FILED
SEP 26 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-348

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.*,
Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.*, IN OPPOSITION TO THE PETITION

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QUESTION PRESENTED

Whether, under the abstention doctrines of *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), and *Younger v. Harris*, 401 U.S. 37 (1971), and this Court's mandate in *Pennzoil Co. v. Texaco Inc.*, 107 S. Ct. 1519 (1987), the United States Court of Appeals for the Fifth Circuit properly affirmed a federal district court's exercise of its discretion to abstain from reviewing the retail level order of a state regulator, where: (a) the district court found that there was no facial conflict between the state regulator's order and the federal regulator's wholesale level determinations; (b) the state courts have been adjudged fully competent to review both state and federal issues, including those arising under the Federal Power Act; (c) review of the retail level order is underway in the state court system; (d) the state court review encompasses issues of state as well as federal law; (e) state court review is consistent with the procedural model followed in the recent *Nantahala Power & Light Co. v. Thornburg*, 106 S. Ct. 2349 (1986), and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 108 S. Ct. 2428 (1988) cases; and (f) the identical issues were presented to this Court in a prior case between the parties where *certiorari* was denied?

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OPINIONS BELOW

The opinion of the Court of Appeals has now been reported at 850 F.2d 1069.

STATEMENT OF THE CASE

A. Introduction

This case marks the third time in as many years that New Orleans Public Service Inc. ("NOPSI") has sought to obstruct state court review of a state regulatory matter of extreme local concern. In each instance, NOPSI has been directed by the federal courts to bring its challenge to state level regulatory orders

of the Council of the City of New Orleans ("Council") in the state judicial system.[1]

This petition represents NOPSI's second attempt to persuade this Court that it must mend an apparent rift in the circuits on the issue of whether abstention by the federal courts can be appropriate in the face of a preemption claim—a divergence of views which is neither as developed nor as intolerable as NOPSI alleges. Analysis of the alleged conflict between the circuits reveals simply a case-by-case effort to determine whether abstention is appropriate in light of such factors as the status of the state proceeding, the extent to which the state action has or is likely to conflict with federal regulation, and the form of abstention at issue.

This Court denied NOPSI's previous petition which presented essentially the same issues (*see* 107 S. Ct. 1910 (1987)),[2] and no different result is warranted

[1] NOPSI's two prior actions include: *New Orleans Public Service Inc. v. City of New Orleans*, Civ. Action No. 85-3398 (E.D.La. dismissed Dec. 16, 1985), *rev'd*, 782 F.2d 1236 (5th Cir. 1986), *modified and withdrawn in part*, 798 F.2d 858 (5th Cir. 1986), *cert. denied*, 107 S. Ct. 1910 (1987) (hereinafter, "*NOPSI I*"); *Middle South Energy, Inc. and New Orleans Public Service Inc. v. Council of the City of New Orleans*, Civ. Action No. 85-5273 (E.D.La. dismissed Dec. 19, 1986), *aff'd*, 833 F.2d 583 (5th Cir. 1987) (hereinafter, "*NOPSI II*").

[2] NOPSI suggests in its petition (at 5, 9) that the Court's denial of its previous petition was due to a ripeness problem. In the *NOPSI I* case, the Council argued that NOPSI's underlying claim of preemption was not ripe since at the time the action was commenced, the Council had not completed its rate proceeding. The issue as to whether or not the federal courts should have abstained was not alleged to be untimely. It is noteworthy that both NOPSI and the Solicitor General took the

here.[3] NOPSI presents no new authority in support of this petition, and, in fact, this Court's position on abstention has been re-emphasized since the denial of *certiorari* in *NOPSI I*. *See Pennzoil Co. v. Texaco, Inc.*, 107 S. Ct. 1519 (1987).

Since 1985, NOPSI has sought to suppress the exercise of retail regulatory oversight by the Council which has, under Louisiana law, plenary authority to regulate the retail electric rates charged by NOPSI to ratepayers in New Orleans. In this case, NOPSI asks the federal courts to enjoin implementation of the Council's "Prudence Investigation: Determinations and Order Regarding the Prudence of the Management of New Orleans Public Service Inc. With Respect to Grand Gulf I" (hereinafter, "Rate Order"). NOPSI has sought the identical relief from the state judicial system, and proceedings are underway there regarding both the merits of the Rate Order and NOPSI's claim that the order is subject to federal preemption. This case thus presents the classic setting for application of this Court's recent instruction that "[s]o long as those challenges [in federal court] relate to pending state proceedings, proper respect for the ability of state courts to resolve federal questions presented in state court litigation *mandates* that the fed-

position that the case was ripe for review despite "procedural problems." As in *NOPSI I*, preemption is not the issue before this Court; rather, the issue is which judicial system, state or federal, should hear in the first instance NOPSI's claim that the Council's regulatory action has been preempted.

[3] Indeed, in a recent letter to the Chief Deputy Clerk, NOPSI anticipated (inaccurately) that respondents might seek an extension of time to answer the petition. Petitioner stated that no additional time should be needed because the issues are the same as those briefed in *NOPSI I*.

eral court stay its hand." *Pennzoil Co. v. Texaco, Inc.*, 107 S. Ct. 1519, 1527 (1987) (emphasis added).

B. Factual Background

In 1985, the Federal Energy Regulatory Commission ("FERC"), in the exercise of its jurisdiction over the sale of wholesale power in interstate commerce, issued an order affixing the allocation of costs for the Grand Gulf I nuclear project among the operating subsidiaries of Middle South Utilities, Inc. ("MSU"). That order *reduced* NOPSI's share to 17 percent from the 29.8 percent NOPSI had volunteered to take in 1980, on the ground that the larger share was unjust and unreasonable. *See Middle South Energy, Inc.*, 31 FERC ¶ 61305 (1985), *aff'd*, 32 FERC ¶ 61425 (1985).

The FERC order set the rates to be paid at wholesale by the MSU operating subsidiaries to System Energy Resources, Inc. ("SERI"), another MSU subsidiary which owns the plant. The FERC order did not address how, whether, or to what extent the Grand Gulf wholesale costs should be borne by retail ratepayers. Significantly, NOPSI did not participate in the Grand Gulf proceeding until after the close of the hearings and evidentiary record, and its retail level responsibilities to the New Orleans ratepayers was never at issue in the proceeding. The Council participated, although it did not have regulatory authority over NOPSI at that time.[4]

[4] In 1981, regulatory control over NOPSI was transferred from the Council to the Louisiana Public Service Commission ("LPSC"). On May 4, 1985, pursuant to a public referendum, the electorate of New Orleans voted to reinvest the Council with the power of supervision, regulation and control over NOPSI. The FERC Grand Gulf proceedings took place during the period

Although NOPSI had become involved in the Grand Gulf project in 1974, when it and the other MSU operating companies agreed to guarantee the indebtedness of SERI for the plant, the Council did not learn of the extent of NOPSI's involvement and the potential impact of the project until 1980. By this time, NOPSI had already committed to take a 29.8 percent share of the plant despite the fact that NOPSI represented only 9 percent of the system load. At a public hearing on September 17, 1980, NOPSI attempted to portray Grand Gulf as a great benefit to ratepayers. When the Council questioned NOPSI as to the propriety of having made such a large commitment without the knowledge or approval of the state regulator, the company's president, James M. Cain, testified, under oath, that New Orleans would *not* have to pay for Grand Gulf should the Council deem it inappropriate and that NOPSI instead would sell its power to other utilities. Mr. Cain assured the Council that:

> If it is in the wisdom of this Council that it is not appropriate for New Orleans Public

the LPSC held this regulatory authority. The LPSC, which also regulates NOPSI's sister company Louisiana Power & Light Co. ("LP&L"), advanced a position before the FERC under which LP&L, the largest company on the system (with approximately 44 percent of the total system load), would be responsible for only 14 percent of Grand Gulf costs, while NOPSI (with only 9 percent of system load) would be responsible for 17 percent of the plant. When it became evident that the LPSC was not fully protecting New Orleans' interests, the Council intervened separately in the FERC proceedings, and recommended that NOPSI receive no more than a 9 percent allocation. The LPSC's position with regard to the shares to be borne by LP&L and NOPSI ultimately was adopted by the FERC.

> Service to participate in this agreement, which they will reflect on through either approval or disapproval of the capacity adjustment clause, through the approval or disapproval of any rate relief we seek as per Grand Gulf, *then NOPSI has the option of selling the capacity and marketing it which, we think, will be a very attractive commodity to other electric utilities who will view this as very, cheap, reliable power for the future.*

In the Matter of NOPSI Rate Hearing—Public Hearing on Electric and/or Gas Rates, Transcript of Proceedings, September 17, 1980 at 547 (emphasis added).

Subsequent to the FERC's allocation order, NOPSI filed an application with the Council to increase its retail rates to recover the costs associated with its Grand Gulf purchase. The increase sought was of approximatelv $160 million per year, a 60 to 70 percent increase. The Council received uncontroverted expert testimony that such a massive rate increase would have subjected the New Orleans community to severe "rate shock", with a threatened loss of thousands of jobs and resulting poverty for many New Orleans residents. The Council initiated a retail rate proceeding to determine issues that must be considered by the retail regulator such as phase-in plans, other forms of rate moderation, allocation of the increase among the utility's classes of customers, and the prudence of the company's exercise of its retail level obligations, including compliance with its franchise with the City.

In March 1986, the Council and NOPSI reached a settlement of NOPSI's application of a rate increase which provided for NOPSI's absorption of $51.2 million of Grand Gulf costs and for a phase-in plan to moderate the adverse effects of rate shock on New Orleans ratepayers. The settlement expressly provided that the Council could continue its inquiry into the prudence of NOPSI's retail level management decisions relating to Grand Gulf. In the resolution initiating the inquiry, No. R-85-636 (October 1985), the Council established the parameters of the inquiry and stated, explicitly, that it would "not seek to invalidate any of the agreements surrounding Grand Gulf I or to order NOPSI to pay [SERI] a rate other than that approved by the FERC."

The prudence inquiry was conducted during 1986 and 1987. On February 4, 1988, the Council issued its 224 page Rate Order, which contains a rigorous analysis of NOPSI's involvement in Grand Gulf. The Rate Order requires a one time disallowance and write-off by NOPSI of a sum equal to $135 million in NOPSI's deferred Grand Gulf I expenses and a reduction in planned rate increases which commenced April 9, 1988 to reflect the disallowance. The Council found that, in general, NOPSI's oversight and review of its Grand Gulf obligation was uncritical and severely deficient. NOPSI's management remained ignorant of important information and significant events that affected its Grand Gulf commitment, and instead was caught up in an effort to portray Grand Gulf as a great benefit to ratepayers.

The disallowance, however, was not based on NOPSI's purchase of Grand Gulf power, but instead was based on the company's failure, in the critical 1979-80 time period, to pursue an available alternative for reducing risks—reselling a portion of its Grand Gulf power to an off-system buyer, and substituting

coal-fired capacity to satisfy NOPSI's future needs.[5] Such a step would have provided much needed diversification of power supply and would have reduced NOPSI's own exposure to the risk (ultimately realized) that Grand Gulf would turn out to be an extraordinarily high cost plant. NOPSI's failure to resell was egregious, in particular, because the company's president had provided public assurances in 1980, in response to pointed questions by its retail level regulator, that NOPSI could resell such power and that the New Orleans ratepayers would not have to pay for Grand Gulf if the Council so ordered.[6] Despite the disallowance, the Rate Order fully accepted the FERC's 17 percent allocation to NOPSI and the Council fashioned a remedy consistent with the company's obligation to pay expenses associated with that allocation.[7]

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[5] By way of analogy, what the Council's order found to be deficient is not NOPSI's decision to commit to, *e.g.*, a lease for office space, but rather its failure to take steps to sublet a portion of that space (in the case of Grand Gulf, through off-system sales) once it became apparent that the office space leased was excessively priced or uneconomic for other reasons.

[6] NOPSI states that it could not have sold power off-system in advance of the final regulatory decision. (Pet. at 6). In fact, the decision is not yet final and it is not at all unusual for utilities to enter into contracts with escape clauses to deal with the impact of regulatory orders.

[7] NOPSI alleges that the $135 million disallowance equates to the 9 percent allocation urged by the Council in the FERC proceeding, and thereby conflicts with the FERC's 17 percent allocation to NOPSI. (Pet. at 6). The prudence disallowance does not equate to a reduction of the FERC allocation to 9 percent. The expert witnesses testifying in the prudence hearing believed that NOPSI should have sold *all* its Grand Gulf share off-system. The Council, however, was willing to impose a *limitation* on that remedy, by assuming that NOPSI at least would have retained a 9 percent share, a portion relative to NOPSI's size in the MSU system. The remaining portion of its 17 percent share also was not written off. The Council allowed that portion to be passed through at the level of coal-fired power. Moreover, yet a further limitation was imposed on the prudence remedy by the Council's concern that NOPSI's solvency be maintained. The Council restricted the disallowance to $135 million to ensure that NOPSI could continue to meet its obligation to SERI and the remainder of the MSU system for the 17 percent allocation. The $135 million disallowance is considerably less than the $476 million disallowance that would have resulted if the Council had merely "reduced" NOPSI's share to 9 percent.

C. Prior Litigation

The history of the litigation between the Council and NOPSI over NOPSI's 1985 request for a rate increase has been torturous. When the Council first initiated its proceeding regarding NOPSI's request for a $160 million per year increase, the company sued the Council in federal district court seeking, *inter alia*, $1 *billion* in damages from the members of the Council, individually and collectively.

The district court dismissed on abstention grounds, rejecting NOPSI's preemption claims, and the Fifth Circuit ultimately affirmed, finding both *Burford*[8] and *Younger*[9] abstention applicable. *See* 798 F.2d 858 (5th Cir. 1986). The Fifth Circuit instructed NOPSI that despite its allegations of federal preemption, abstention was appropriate since "the regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise." 798 F.2d at 862. NOPSI then filed a petition for *certiorari* with this Court alleging, as it has here, that abstention is improper when a

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[8] *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943).

[9] *Younger v. Harris*, 401 U.S. 37 (1971).

preemption claim has been presented and that this issue has "polarized" the Courts of Appeal. This Court denied NOPSI's petition. *See* 107 S. Ct. 1910 (1987).

NOPSI initiated its second action against the Council in October 1985 when the Council commenced its prudence inquiry. NOPSI sought to enjoin the inquiry again on the ground of alleged federal preemption. The district court dismissed on the basis of abstention and lack of ripeness. The appellate court affirmed the ripeness holding and did not reach the alternative abstention issue. *See* 833 F.2d 583 (5th Cir. 1987). NOPSI sought rehearing, which was denied on January 19, 1988. When the Council issued its Rate Order on February 4, 1988, NOPSI asked the Fifth Circuit to recall the mandate and to grant injunctive relief, once more asserting that the Council's actions were preempted by the FERC allocation. The court denied NOPSI's motion on March 3, 1988.

This action ("*NOPSI III*") was commenced several days after the Council's issuance of its Rate Order. NOPSI sought to enjoin implementation of the Rate Order, alleging federal preemption, impermissible collateral attack on the FERC orders, exclusive federal court jurisdiction, and interference with interstate commerce. The district court dismissed on abstention grounds, rejecting NOPSI's argument that the Council's actions were wholly preempted by the FERC's Grand Gulf allocation and additionally rejecting NOPSI's assertion of exclusive federal jurisdiction. The court found no facial conflict between the Council's Rate Order and the FERC Grand Gulf determinations:

> The Rate Order, on its face, sets only retail rates; it does not attempt to order that NOPSI pay SERI any amount different from that order by the FERC. Thus, there is no facial conflict with FERC Opinion No. 234. Furthermore, the division of federal and state authority in the Federal Power Act makes it clear that the government has not entirely preempted state regulation of retail sales of electricity.

App. 32A.

After losing in the district court and unsuccessfully seeking an injunction pending appeal, NOPSI asked the Fifth Circuit for a similar injunction, raising the same federal preemption issues it had asserted below. The court denied NOPSI's motion but granted the company's unopposed request for an expedited appeal. On July 28, 1988, the Fifth Circuit issued its opinion affirming the district court's decision to abstain.

Apparently heeding the district court's advice in *NOPSI III* that its "plea for relief should be litigated first in the state court forum" (App. 33A), NOPSI also filed suit for review of the Council's Rate Order in the Civil District Court for the Parish of Orleans. Two additional lawsuits were filed with regard to the Rate Order: one by the Council itself seeking to enforce the order and another by citizens' groups seeking a considerably higher disallowance due to NOPSI's imprudent management.

NOPSI's original complaint attacked the Rate Order on a number of state law grounds, *e.g.*, that the Council's Order is arbitrary, capricious and not supported by substantial evidence; that it applies an erroneous standard of prudence; that it breaches the March 1986 settlement agreement between NOPSI

and the Council; that the procedures used by the Council in conducting the prudence inquiry violated NOPSI's right to procedural due process under the Louisiana constitution; and that the prudence disallowance constitutes a taking without just compensation and a denial of substantive due process rights under the Louisiana constitution. NOPSI subsequently amended its complaint to raise the federal issues of preemption, collateral attack on the FERC decision, and interference with interstate commerce. The Council has asserted the affirmative defense of estoppel, an additional state law issue.

On April 15, 1988, NOPSI filed a motion in the state court proceeding seeking a preliminary injunction to bar implementation of the Council's Rate Order. NOPSI's motion was based *solely* on the federal issues contained in its amended complaint. The Civil District Court denied NOPSI's motion by an order entered on May 5, 1988, finding that "the actions taken by the City do not conflict, frustrate, or interfere, with the wholesale rate making authority of FERC and therefore, do not violate federal law."[10] The matter has been appealed to the Louisiana Court of Appeal for the Fourth Circuit and briefs have been filed.

Meanwhile, the three consolidated cases are being heard on the merits by the Civil District Court. Opening briefs, including a motion for summary judgment by the Council, were filed on August 8, 1988, and responsive pleadings were filed on September 20, 1988.

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[10] *New Orleans Public Service Inc. v. Council of the City of New Orleans*, No. 88-4511, Reasons for Judgment at 3 (C.D.C. Par. Orleans, May 5, 1988).

REASONS FOR DENYING THE PETITION

A. The Apparent Conflict Among The Circuits Presented By Petitioner Is Illusory: The Variance In Results Simply Reflects A Case-By-Case Analysis Rather Than Adherence To A "*Per Se*" Rule

NOPSI premises its request for review on an alleged direct conflict between the abstention holdings of the Fifth Circuit and those of other federal courts of appeal. In truth, there exists no hard and fast rule for or against abstention in the face of a preemption claim.[11] Rather, the lower courts have proceeded on a case-by-case basis, and have analyzed the propriety of abstention in light of such factors as the status of the state proceeding, the extent to which the state action has or is likely to conflict with the federal scheme, and the form of abstention alleged. If there is one point all the circuits that have considered the issue (including the Fifth Circuit) appear to agree upon, it is that they will not hesitate to exercise jurisdiction where the state and federal actions are in *direct* conflict and that conflict is readily discernible from the pleadings. Careful analysis of the cases presented by NOPSI in its petition reveals that there is no "conflict" which requires plenary review by this Court. The flexibility and effectiveness of the lower courts in addressing abstention on a case-by-case basis

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[11] During consideration of the *NOPSI I* petition for *certiorari*, the Solicitor General, writing as *amicus* on behalf of the United States and the FERC, agreed that "there is, of course, no *per se* rule against abstention in a federal preemption case; rather, the propriety of abstention depends on the nature of the particular preemption claim at issue." *See* "Brief for the United States and the Federal Energy Regulatory Commission As *Amici Curiae*", *American Electric Power Co. v. Kentucky Public Service Commission*, No. 86-49 (U.S. Sup. Ct., filed March 26, 1987).

and the absence of any need for further guidance from this Court are illustrated by examining not just the results reached by different circuits but also the different results reached by particular circuits in varying factual and legal contexts.

The Fourth Circuit's treatment of the propriety of abstaining in the face of a preemption claim exemplifies the issue. In *Aluminum Company of America v. Utilities Commission of the State of North Carolina*, 713 F.2d 1024 (4th Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984), the court abstained under *Burford* from reviewing a state commission rate order which involved "important and basic considerations of state policy."[12] The court viewed the case as presenting "the quintessential setting of a complex state regulatory scheme concerning important matters of state policy for which impartial and fair administrative determination subject to expeditious and adequate judicial review are afforded." 713 F.2d at 1029.[13]

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[12] The state court's ensuing treatment of the preemption claims led to this Court's decision in *Nantahala Power & Light Co. v. Thornburg*, 106 S. Ct. 2349 (1986). While ultimately disagreeing with the state court, this Court apparently found the state review process to be beneficial, and it complimented the state court for "an admirably thorough consideration of the myriad issues before it." 106 S. Ct. at 2354.

[13] The Sixth Circuit has, as well, upheld abstention despite allegations that a state public service commission was seeking to displace or ignore a FERC-approved rate agreement. *American Electric Power Co. v. Kentucky Public Service Commission*, No. 85-5129 (6th Cir. Mar. 24, 1986), *cert. denied*, 107 S. Ct. 1910 (1987). Although the court did not view *Burford* abstention as applicable, abstention under *Younger* was proper since a state court proceeding to review the state commission's action was underway.

Notably, the court declined to adopt a *per se* rule. Rather, it opined that a refusal to abstain would be required where the preemption claim is well-founded and the conflict is readily discernible from the pleadings, such as where the federal government has preempted the field or "where there is a *direct, facial* conflict between state and federal statutes." *Id.* at 1030 (emphasis added).

Subsequently, the Fourth Circuit upheld a lower court's refusal to abstain where the state commission, in reliance upon a West Virginia statute, created a "direct, facial conflict" with federal law by asserting authority to disapprove an interstate transmission agreement previously approved by the FERC. *Appalachian Power Co. v. Public Service Commission of West Virginia*, 614 F. Supp. 64 (S.D.W. Va. 1985), *aff'd*, 770 F.2d 159 (4th Cir. 1985). Critical to the district court's decision not to abstain was the fact that the state commission sought to decide the *identical* issues already decided by the FERC. 614 F. Supp. at 71; *see also Appalachian Power Co.*, 630 F. Supp. 656, 663 (S.D.W. Va. 1986), *aff'd*, 812 F.2d 898 (4th Cir. 1987).

The Fifth Circuit itself has refused to abstain from intervening in an on-going state administrative proceeding where the preemption claim was well-founded. In *South Central Bell Telephone Co. v. Louisiana Public Service Commission*, 744 F.2d 1107 (5th Cir. 1984), *vacated and remanded on other grounds*, 106 S. Ct. 1884 (1986), the Fifth Circuit found that regulatory action by the Louisiana Commission was "directly contrary" to an order issued by the Federal Communications Commission and that the case was "in no way dependent on local factors or local expertise

for [its] resolution." 744 F.2d at 1123. Under such circumstances, abstention was held to be improper.

The Third Circuit similarly has refused to apply a *per se* rule of abstention stating that it "would, admittedly, be an overstatement to suggest that *Younger* abstention is never appropriate when the question presented is one of preemption." *Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Commission*, 791 F.2d 1111, 1117 (3d Cir. 1986). A key purpose of the abstention doctrine is to avoid federal interference in state proceedings which could develop particular state policies and solutions. In this case, the court declined to abstain where the state response and policy had already been fully articulated—in fact, by all three branches of the Pennsylvania government. Despite its decision that abstention was improper, the court reconciled its ruling with the Fourth Circuit's holding in *Aluminum Company of America*, noting that the case before it presented an issue of facial conflict between federal and state statutes. *Id.* at 1116 n.6.

A direct conflict between federal law and state action was plain on the face of pleadings in the Eighth Circuit's review of *Middle South Energy, Inc. v. Arkansas Public Service Commission*, 772 F.2d 404 (8th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986), a case relied upon by NOPSI (Pet. at 11). In *Middle South Energy*, the Arkansas commission had initiated a proceeding requiring the utility (a sister company to NOPSI) to "show cause why all contracts and agreements made by it with respect to . . . the Grand Gulf project should not be held void *ab initio* as a matter of law", 772 F.2d at 408, to the end that the utility might avoid paying *any* of the interstate costs as-

signed by the FERC. Since the contracts and agreements involved provided the basis for the FERC's decision, and because the Arkansas commission was trying to secure for Arkansas "the zero allocation" already rejected by the FERC (*id.* at 411), there was indisputable and complete preemption of the proposed state action—a situation wholly unlike that involved in the Council's Rate Order, which explicitly preserves the federal allocation and related agreements.[14] With this finding of preemption, the court did not see a reason to abstain. *Id.* at 417.[15]

The Ninth Circuit's view on the issue is similar to that of the other circuits that have considered the issue: where the fact of preemption is "readily apparent", abstention is unwarranted. *See Fresh International Corp. v. Agricultural Labor Relations Board*, 805 F.2d 1353, 1361 (9th Cir. 1986) (a case not cited by NOPSI). In that case, the court held in *favor* of abstention and distinguished its apparently contradictory holding in *Champion International Corp. v. Brown*, 731 F.2d 1406 (9th Cir. 1984) (a case relied

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[14] The distinction between the facts underlying this case and the actions of the Arkansas commission are stark. *See NOPSI I*, 798 F.2d at 863 n.1. It is remarkable that NOPSI nevertheless characterizes the result in the two cases as dependent upon "the fortuity of whether the supplicant and the courthouse are in Arkansas or Louisiana." (Pet. at 14).

[15] The Eighth Circuit echoed this view two years later in another Grand Gulf case, *Arkansas Power & Light Co. v. Missouri Public Service Commission*, 829 F.2d 1444 (8th Cir. 1987), noting that where a challenge to a state regulatory action is based on preemption, abstention is "*seldom* applicable." *Id.* at 1450 (emphasis added).

upon by NOPSI),[16] stating "[w]e did not say in *Champion* that abstention never is appropriate when a preemption claim is raised. . . . Rather, *Champion* was a case in which preemption was readily apparent. . . . In the case before us, preemption is not readily apparent." *Id.* at 1361. In *Champion*, the court had found that "Congress has shown clearly its interest in uniform regulation of pension plans and its intention to establish pension plan regulation as *exclusively* a 'federal concern' " (*id.* at 1408, emphasis added),[17] a situation that is unlike the divided jurisdiction embodied in the Federal Power Act.

Thus, the Courts of Appeal have almost uniformly shown sensitivity to the factual and legal context of the abstention cases before them. Where the courts

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[16] NOPSI also relies upon *International Brotherhood of Electric Workers v. Public Service Commission of Nevada*, 614 F.2d 206 (9th Cir. 1980), and *Knudsen Corp. v. Nevada State Dairy Commission*, 676 F.2d 374 (9th Cir. 1982). These cases also found that if a preemption claim is well-founded, abstention cannot be appropriate, since abstention would implicitly involve a ruling on the merits. *International Brotherhood*, 614 F.2d at 212 n.1; *Knudsen*, 676 F.2d at 377. Although the court's ruling is consistent with its explanation in *Fresh International* that the propriety of abstention is dependent on the vitality of the federal preemption claim, its logic appears to be flawed. If the propriety of abstention is based on whether or not the preemption claim is well-founded, the court's decision *not* to abstain also would implicitly involve a ruling on the merits.

[17] *Baggett v. Department of Professional Regulation*, 717 F.2d 521 (11th Cir. 1983), is to a similar effect. The state attempted to regulate the pilotage of enrolled vessels, a matter subject to *exclusive* federal regulation. *Id.* at 523. The court noted that it would be "an overstatement to suggest that when the federal question is one of preemption, abstention under the principle of *Younger v. Harris* is never appropriate." *Id.* at 524.

have been convinced that a claim of federal preemption is well-founded, *i.e.*, where there is a direct, facial conflict between the state and federal action, abstention has been viewed as unwarranted. Resolution of the underlying preemption claims is, of necessity, fact dependent, and no *per se* rule can be fashioned to address the propriety of abstention in such circumstances.

B. The Fifth Circuit's Decision To Allow Abstention In Accordance With Its *NOPSI I* Opinion Was Proper

In affirming the district court's decision to abstain, the Fifth Circuit relied principally upon its holding in *NOPSI I* that abstention was warranted under both *Burford* and *Younger*. Critical to the court's holding in that case was the structure of the Federal Power Act, with its "bright line" between federal regulation of sales at wholesale to local distribution utilities and state regulation of the rates charged at retail to ultimate consumers. *See NOPSI I*, 798 F.2d at 860:

> The existence of this "bright line" colors the way we view a preemption claim involving the Federal Power Act. NOPSI has attempted to depict the situation before us as one in which the Council is stepping into the realm of *wholesale* rate making, a field under the exclusive jurisdiction of FERC. NOPSI focuses on the disruption of a *federal* scheme. Yet federal court intervention here may constitute a disruption of a *state* regulatory scheme, for *retail* rate making is clearly a field left to the jurisdiction of the states.

Id. The court thus held that

> Although we do not intimate that abstention in the face of a preemption claim under the Federal Power Act may never constitute an abuse of discretion, abstention should perhaps more often obtain in cases presenting a question of preemption under the Federal Power Act than would be so in cases presenting other types of federal preemption claims.

Id. at 861. In the decision below, the court found no reason to stray from this course. App. 17A-18A.

1. *Burford* Abstention Was Proper In Light Of The Availability Of State Court Review Of A Matter That Encompasses Issues Of Deep Local Concern

In both *NOPSI I* and the proceeding below, the Fifth Circuit applied *Burford* abstention. This doctrine is appropriate where there exists a comprehensive state regulatory scheme and where federal interference would disrupt efforts to develop a reasoned response to matters of legitimate local concern. The Council's Rate Order involves such concerns.[18] The order represents the Council's efforts to maintain oversight over NOPSI's obligations under its franchise to efficiently and economically manage and operate its properties and its responsibility to the ratepaying community to carry out prudent utility operations. NOPSI's obligation to the New Orleans' community is not altered by its membership in an interstate holding company arrangement. In the Rate Order, the Council undertook the complicated task of balancing

[18] *See NOPSI I*, district court slip op. at 14 and 798 F.2d at 862; *NOPSI II*, district court slip op. at 8-9 and 833 F.2d at 587; *NOPSI III*, App. 17A, 31A-33A.

its legitimate local interest—indeed, its obligation—to redress the company's blatant disregard of its retail level duties against NOPSI's responsibility under the FERC wholesale rate order. In the words of the Fifth Circuit, "the regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise. The regulatory system is complex." App. 17A. *Burford* abstention thus is justified.

Burford abstention also depends on the availability of state court review of local regulatory actions. The competence of the Louisiana courts to address the merits of the Council's Rate Order and any federal claims asserted by NOPSI cannot be doubted. The Fifth Circuit found the local courts to be "fully able" to address such matters.[19] App. 17A. Moreover, abstention would not "foreclose [this Court] from entertaining NOPSI's preemption claims should it wind its way up through the state courts, as is demonstrated by the path of the recent *Nantahala* case." *Id.* at 18A. NOPSI apparently has acquiesced in this view. It has sought review of the Council's Rate Order in the state judicial system with respect to both the merits of the findings and its preemption claims. NOPSI's complaint and the Council's response thereto embrace significant state law issues as to which the state courts should be permitted to speak.

NOPSI asserts that state courts cannot have an overriding interest in adjudicating preemption claims,

[19] That the Louisiana courts are fully able to address federal preemption and indeed, have found preemption, is evidenced by such cases as *Thibodeaux v. Thibodeaux*, 454 So. 2d 813 (La. 1984), *cert. denied*, 469 U.S. 1114 (1985); and *State v. Jenkins*, 107 So. 2d 648 (La. 1958), *cert. denied*, 359 U.S. 998 (1959).

particularly under the Federal Power Act. (Pet. at 10.) The contrary is true. The Federal Power Act contains an express reservation of authority for the states; hence, regulation of utility matters is not an area in which Congress has intended the federal government fully to occupy the field. Additionally, this Court has held that the "filed rate doctrine", which provides that FERC-established wholesale rates are binding in judicial proceedings, is applicable to state court proceedings. *See Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 581-82 (1981); *Nantahala Power & Light Co. v. Thornburg*, 106 S. Ct. 2349, 2355 (1986). The state courts thus are able and obligated to address Federal Power Act issues placed before them. *Nantahala*, 106 S. Ct. at 2356-57.

2. *Younger* Abstention Was Proper In View Of The Ongoing State Judicial Proceeding

In both *NOPSI I* and the proceeding below, the Fifth Circuit also found abstention appropriate under the *Younger* doctrine. Indeed, *Younger* abstention may be more warranted now than at any previous stage of the controversy between the Council and NOPSI, since a state court lawsuit for review of the Council's Rate Order is underway.

Younger " 'espouse[s] a strong federal policy against federal court interference with pending state judicial proceedings absent extraordinary circumstances.' " *NOPSI I*, 798 F.2d at 863, *quoting Middlesex County Ethics Committee v. Garden State Bar Association*, 457 U.S. 423, 431 (1982). As held by the Fifth Circuit, "*Younger* would justify abstention because the Council proceedings constituted an ongoing state judicial proceeding, involving important state interests, and

in that proceeding NOPSI had an opportunity to litigate its federal claims." App. 18A.

In recent years, this Court has grown increasingly emphatic regarding the need to preserve the notion of comity through application of the *Younger* doctrine. Thus, in *Ohio Civil Rights Commission v. Dayton Christian Schools*, 106 S. Ct. 2718, 2728 (1986), the Court stressed that "the *normal* thing to do when federal courts are asked to enjoin pending state proceedings in state courts is not to issue such injunctions." Similarly, in *Pennzoil Co. v. Texaco, Inc.*, 107 S. Ct. 1519, 1527 (1987), the Court issued a "mandate" that when a challenge in federal court relates to pending state proceedings, "the federal court [must] stay its hand."

NOPSI argues that the Court has upheld the authority of federal courts to enjoin state utility actions on preemption grounds, without addressing whether abstention was required or permitted. (Pet. at 10). Two of these cases, *Public Utilities Commission of Ohio v. United Fuel Gas Co.*, 317 U.S. 456 (1943), and *Public Utilities Commission of California v. United States*, 355 U.S. 534 (1958), were decided long before the Court's abstention holdings, particularly as represented by the *Younger* doctrine, had reached the level of development evident today. The *United Fuel* case, nevertheless, reviewed abstention under *Railroad Commission of Texas v. Pullman Co.*, 312 U.S. 496 (1941), and found it distinguishable. 317 U.S. at 463. The decision repeats the Court's admonition that federal courts "should be wary of interrupting the proceedings of state administrative tribunals by use of the extraordinary writ of injunction." *Id.* at 468. However, the rule is "not to be applied in blind dis-

regard of fact" (*id.* at 469), and the facts before the Court revealed the state commission orders to be "plainly invalid." *Id.* In the third case cited by NOPSI, *Schneidewind v. ANR Pipeline Co.*, 108 S. Ct. 1145 (1988), there was no pending state action, administrative or judicial.[20] Plainly, these cases do not advance NOPSI's position that federal court abstention is unwarranted here.

C. There Is No Facial Conflict Between The Council's Retail Level Rate Order And The FERC's Wholesale Level Allocation Of Grand Gulf Costs That Would Warrant Federal Court Intrusion Into Ongoing State Proceedings

NOPSI alleges that the Council's Rate Order collaterally attacks and disregards the FERC's Grand Gulf allocation decision (Pet. at 10, 13), apparently seeking to bring itself under the rule noted above that abstention may not be warranted where there is a direct, facial conflict between federal and state action. No court to date has adopted NOPSI's view that the Council's effort to fashion an entirely retail level response to NOPSI's gross mismanagement assails the FERC's designation of 17 percent of the Grand Gulf costs to NOPSI. In each of three federal lawsuits it has brought against the Council, NOPSI has alleged such "complete" preemption of the Council's retail rate authority, and in each instance, it has been rejected on this point. *See* "Prior Litigation", *supra*. Additionally, the Louisiana trial court, which reviewed NOPSI's preemption claims on its motion for a preliminary injunction, found no such conflict. That decision now is before the state appellate court on its review of the denial of NOPSI's motion. NOPSI also has raised the issue anew before the Louisiana Civil District Court in its briefs on the merits of the Council's Rate Order. The decision of the Civil District Court will be subject to review by the higher Louisiana courts and, if necessary, by this Court. This is precisely the procedural path followed in the *Nantahala Power & Light Co. v. Thornburg*, 106 S. Ct. 2349 (1986), and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 108 S. Ct. 2428 (1988) cases heralded by NOPSI.

In its attempt to profile this case as essentially a preemption (rather than abstention) matter, NOPSI has alleged that the facts are identical to those in the recent *Mississippi Power & Light* preemption ruling by this Court.[21] This represents a serious misportrayal of the facts of this case. While the *Mississippi Power & Light* case arose out of the Grand Gulf controversy and did involve a proposed prudence investigation, its similarity to the instant case ends with those facts. The differences, on the other hand, are significant:

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[20] *Public Utilities Commission of California* lacked the procedural complication of an ongoing judicial proceeding as well. There, the case had been filed by the United States before a three-judge district court.

[21] The state courts have not yet had the opportunity to rule on whether the *Mississippi Power & Light* decision addresses the issues considered by the Council in its Rate Order. (The Council submits that it does not.) The state courts should be allowed to rule on the issue in light of a fully developed factual record before federal review is warranted. *See Nantahala*, 106 S. Ct. at 2354.

The State of Mississippi—

(1) sought to adjudge the prudence of MP&L's decision to *participate* in the Grand Gulf project;

(2) sought to adjudge the prudence of the decision to *construct*, and continue construction of Grand Gulf I; and

(3) asserted authority, on the basis of such prudence determinations, to set rates based on an assumption that MP&L is obligated to *purchase less* Grand Gulf power than FERC has ordered it to purchase.

See, e.g., 108 S. Ct. at 2439, 2441.

In contrast, the Council in its Rate Order—

(1) disavowed authority to take any action based on NOPSI's decision to participate in Grand Gulf;

(2) disavowed authority to review the prudence of constructing or completing Grand Gulf I; and

(3) fully accepted NOPSI's FERC-determined allocation as a given, taking no steps that would prevent NOPSI from fully satisfying that obligation, and basing its imprudence disallowance solely on actions NOPSI failed to take at the retail level to mitigate the risks it confronted.

See NOPSI III, App. 30A, 32A-33A. The critical facts thus are reversed. The Council assumed that NOPSI would be obligated to take and pay for a share of Grand Gulf. It then asked whether management, facing such an obligation, properly could do absolutely nothing in the face of (1) deteriorating economic circumstances and (2) the management's own assurance to the state regulator that the ratepayers would not have to bear the costs of Grand Gulf and that NOPSI could sell power off-system if the Council so decided. The errors found fatal in the Mississippi court's ruling simply are not present here.

Moreover, the retail level issue of off-system sales—which lies at the heart of the Rate Order—is wholly absent from *Mississippi*. It is an issue that was not and could not have been the subject of the wholesale level allocation proceeding before the FERC. The FERC has no jurisdiction to examine a utility's choices in carrying out its retail level obligations. NOPSI, a regulated utility operating pursuant to a franchise with the City of New Orleans, should not be permitted to shield itself from the consequences of its retail level mismanagement merely by virtue of its participation in a multistate holding company arrangement.

CONCLUSION

WHEREFORE, for all the foregoing reasons, NOPSI's petition should be denied.

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No. 88-348

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

NEW ORLEANS PUBLIC SERVICE INC.,

Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, JOSEPH I. GIARRUSSO, LAMBERT C. BOISSIERE, JR., MICHAEL EARLY, JAMES SINGLETON, DOROTHY MAE TAYLOR, JOHNNY JACKSON, and PEGGY WILSON,

Respondents.

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In the respondents' view, "[t]his case marks the third time in as many years that [petitioner] has sought to obstruct state court review of a state regulatory matter of extreme local concern." Opp. p. 1. Petitioner's view is different: this is the third time that lower courts have improperly rebuffed petitioner's efforts to have a federal court vindicate explicit federal rights and prevent the massive "trapping" of petitioner's FERC-mandated Grand Gulf 1 costs.

Respondents' Opposition confirms that Supreme Court review of the abstention issue is not only appropriate now, but a matter of great national importance. Respondents cannot, and do not, dispute that three things have happened in the year and a half since the Solicitor General, in response to this Court's invitation, recommended that the Court review the abstention issue present-

ed in this case. First, as the respondents concede (Opp., pp. 7-8), the "procedural problems" identified by the Solicitor General have disappeared, and the abstention issue is now indisputably ripe. Second, this Court's June, 1988 decision in *MP&L*[1] has laid to rest any doubt that the sole issue to be presented to the federal court is one of federal law. Third, the Fifth Circuit—from whose judgment this petition is taken—has expressly stated that its abstention holdings conflict with those of numerous other courts of appeals. App. 20a. It recognizes that petitioner's clear federal rights under *MP&L* would probably have been vindicated by now, and this case would have come to an end, if the case had arisen in any one of at least three other courts of appeals. App. 15a. The Fifth Circuit has also issued an unusual plea that this Court resolve the conflict. App. 20a.

Respondents' sole response is to argue that there is nonetheless no conflict. Respondents claim that the courts of appeals that refuse to abstain in the face of a preemption claim do so only where preemption is "readily apparent." Opp., pp. 13-25. Respondents miss the obvious point. A "readily apparent," dispositive federal rule is precisely what this case involves. For years, before FERC and elsewhere, the respondent New Orleans City Council ("New Orleans") has contended that a fair Grand Gulf 1 allocation for New Orleans is 9%. It lost that argument before FERC, which assigned a 17% allocation to New Orleans. This Court in *MP&L* held that state retail regulators cannot avoid FERC's Grand Gulf 1 allocation under the guise of a prudence review. Yet that is precisely what the New Orleans "rate order" has done. To be sure, New Orleans asserts that its prudence review is different from the prudence review suggested by the Mississippi Supreme Court (Opp., pp. 25-27), but this assertion ignores the *MP&L* holding that all state prudence reviews are foreclosed by the very FERC allocation of Grand Gulf 1 that is at issue here.

[1]*Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, No. 86-1970, 56 U.S.L.W. 4751 (June 24, 1988).

Accordingly, the sole argument advanced by petitioner in the Louisiana federal court was the same as this Court's eventual holding in *MP&L*: that retail regulators must include FERC-approved wholesale costs within their retail rates.[2] New Orleans has done the same thing that Mississippi attempted to do—exclude some or all of the FERC-allocated Grand Gulf 1 costs from retail rates.[3] Federal law prohibits the New Orleans action just as it prohibited the Mississippi attempt. And because this federal principle is dispositive of the entire dispute between petitioner and respondents, petitioner is entitled to have this federal principle declared by a federal court.

The Fifth Circuit's plea should be heeded. The petition for certiorari should be granted.

[2]All of the cases between New Orleans and petitioner were decided without the guidance of *MP&L* except for the July 28, 1988 Fifth Circuit decision on which review is sought.

[3]In its Opposition, New Orleans quotes from its Resolution No. R-85-636 (p. 7) but omits the most pertinent portion of that Resolution:

> "The Council's investigation shall include inquiry into all aspects of NOPSI's prudence regarding its decisions to enter into its arrangements to purchase a portion of Grand Gulf 1 for the purpose of determining what portion, if any, of NOPSI's Grand Gulf 1 expense shall be assumed by its shareholders, rather than passed through to its retail ratepayers."

"NOPSI's Grand Gulf 1 expense" results solely from the FERC allocation.

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Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.* IN OPPOSITION TO THE VIEWS OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-348

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.*
Respondents.

BRIEF OF THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.* IN OPPOSITION TO THE VIEWS OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

This brief is submitted by the Council of the City of New Orleans ("Council") in opposition to the brief expressing the views of the Solicitor General on behalf of the United States and the Federal Energy Regulatory Commission ("FERC") as *amici curiae* (hereinafter referred to as "U.S. Br."). The brief of the Solicitor General contains five flaws fatal to its position that NOPSI's petition for review should be granted.

1. *The state court system can adequately address NOPSI's claims.* The Solicitor General has made no showing that the state court system cannot properly adjudicate NOPSI's claim that the Council's retail

level rate order is preempted by the FERC's wholesale level allocation of Grand Gulf costs. The Fifth Circuit found the local courts to be "fully able" to address such matters. App. 17A. The Louisiana courts have ably handled claims of federal preemption in the past. *See, e.g., Thibodeaux v. Thibodeaux*, 454 So.2d 813 (La. 1984), *cert. denied*, 469 U.S. 1114 (1985); *State v. Jenkins*, 107 So.2d 648 (La. 1958), *cert. denied*, 359 U.S. 998 (1959). "Minimal respect for the state processes . . . precludes any *presumption* that the state courts will not safeguard federal constitutional rights." *Middlesex County Ethics Committee v. Garden State Bar Association*, 102 S. Ct. 2515, 2521 (1982).[1] The Louisiana courts also are highly experienced in review of utility regulatory matters, and have not hesitated to overturn regulatory actions which they deemed inappropriate. *See, e.g., Central Louisiana Electric Co. v. Louisiana Public Service Commission*, 508 So.2d 1361 (La. 1987); *Gulf States Utilities Co. v. Louisiana Public Service Commission*, No. 325,224 (La. Dist. Ct. Feb. 18, 1988).

2. *There is ongoing state court litigation involving identical issues of law and fact.* This case is a paradigm for application of the *Younger*[2] abstention doctrine: the same preemption claim raised by NOPSI in its federal lawsuit currently is being considered by the Louisiana Court of Appeal for the Fourth Circuit

[1] The Solicitor General, without reference to record evidence, inappropriately ascribes bias to the Council's regulatory processes. *See* U.S. Br. at 12 n.12. If this were true, it is a matter that the state courts would be fully capable of addressing.

[2] *Younger v. Harris*, 401 U.S. 37 (1971). Abstention under *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), is proper as well. *See* App. 17A.

on appeal of the denial of NOPSI's preliminary injunction motion[3] and is also before the Civil District Court for the Parish of Orleans as one issue in that court's in-depth review of the merits of the Council's Rate Order.[4] The state court system has this matter well in hand. There simply has not been a showing that it is appropriate for this Court to interrupt the state judicial process for reviewing retail level regulatory decisions.

The Solicitor General also overlooks the uncontroverted fact that state law issues form an integral part of NOPSI's state court lawsuit. Preemption is only one ground on which NOPSI has sought review of the Council's Rate Order, and the Council has raised several critical issues of state law in defense of its order. *See* Council's Brief at 11-12.

Younger abstention is based on a strong federal policy that the federal courts should not enjoin pending state court proceedings. *See Pennzoil Co. v. Texaco, Inc.*, 107 S. Ct. 1519 (1987); *Ohio Civil Rights Commission v. Dayton Christian Schools*, 106 S. Ct. 2718 (1986). This is not a case of merely concurrent federal and state proceedings invoking considerations of "wise judicial administration" such as existed in *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 818 (1976). NOPSI has asked the federal courts to *enjoin* state judicial processes arising from the Council's Rate Order. Hence,

[3] Briefs have been filed and oral argument is scheduled for January 10, 1989.

[4] Dispositive motions and briefs have been submitted to the Civil District Court for the Parish of Orleans. Oral argument was held before the court on November 30, 1988.

"weightier considerations of constitutional adjudication and state-federal relations" are involved. *Id.* The Solicitor General's reliance on *Colorado River* (U.S. Br. at 10) is therefore misplaced.

3. *The Solicitor General previously has conceded that the comity considerations of Younger warrant abstention in these circumstances.* Two years ago, the Solicitor General took a significantly different position in a case presenting a similar factual setting. *See* "Brief for the United States and the Federal Energy Regulatory Commission as *Amici Curiae*" in *American Electric Power Co. v. Kentucky Public Service Commission*, No. 86-49, a copy of which is appended to the Solicitor General's current submission to the Court. In the *AEP* brief, the Solicitor General urged that the Court grant review in the *NOPSI I*[5] case, but not in *AEP*. In *AEP*, a state court had issued a judgment on the preemption claims as to which federal review also was sought and the matter was pending before a state appellate court. The Solicitor General stated that *AEP* was "not an attractive candidate for review" in part because the state judicial proceeding "injects comity considerations into *AEP*" which the Solicitor General did not believe existed in *NOPSI I*. *See AEP* Brief at 23 and 25 n. 16.[6]

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[5] *New Orleans Public Service Inc. v. Council of the City of New Orleans*, Civ. Action No. 85-3398 (E.D. La. dismissed Dec. 16, 1985), *rev'd*, 782 F.2d 1236 (5th Cir. 1986), *modified and withdrawn in part*, 798 F.2d 858 (5th Cir. 1986), *cert. denied*, 107 S. Ct. 1910 (1987).

[6] The Solicitor General alleges that the Court's denial of *certiorari* in *NOPSI I* was due to "procedural problems" which have now disappeared. U.S. Br. at 5, 19. Notably, in its *AEP* brief, the Government did not view those problems as barriers to the Court's acceptance of NOPSI's petition.

NOPSI's preemption claims are under consideration by the Louisiana courts, and the same respect for federal-state relations is appropriate here. Indeed, the two cases cited by the Solicitor General and NOPSI as favoring preemption of the Council's actions stand as models for the process urged by the Council and the Fifth Circuit, *i.e.*, initial state level review of regulatory decisions in state court with ultimate review by this Court if needed. *See Nantahala Power & Light Co. v. Thornburg*, 106 S. Ct. 2349 (1986); *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 108 S. Ct. 2428 (1988).

4. *The alleged conflict between the circuits has not intensified since this Court's consideration of the issue in NOPSI I in which certiorari was denied.* The Solicitor General fails to recognize that the alleged conflict in the circuits is no more pronounced now then it was when this Court denied *certiorari* in *NOPSI I*. Indeed, the same cases are cited by the Government in its *AEP* brief and its current submission.[7]

Furthermore, the abstention controversy alleged by the Solicitor General is not substantial. The lower federal courts, including the Fifth Circuit, have determined the propriety of abstention in the face of a preemption claim on a case-by-base basis. Close analysis of the cases reveals that when the courts are convinced that a *direct, facial* conflict exists between state and federal regulatory actions, they will not hesitate to exercise their jurisdiction. For example, *compare NOPSI I* and the decision below with *South Central Bell Telephone Co. v. Louisiana Public Service*

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[7] *Cf.* U.S. Br. at 16-18 to the Government's *AEP* Brief at 20-22.

Commission, 744 F.2d 1107 (5th Cir. 1984), *vacated and remanded on other grounds*, 106 S. Ct. 2884 (1986). *See also Aluminum Company of America v. Utilities Commission of the State of North Carolina*, 713 F.2d 1024 (4th Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984), and *Appalachian Power Co. v. Public Service Commission of West Virginia*, 770 F.2d 159 (4th Cir. 1985).

5. *Federal court jurisdiction is not required to resolve the dispute between NOPSI and the Council.* The Solicitor General incorrectly assumes that the Council's Rate Order encompasses interstate issues and that federal court jurisdiction thus is mandated. In doing so, the Solicitor General confuses the issue of FERC jurisdiction over interstate wholesale power contracts with the issue of which court system—state or federal—must give effect to such determinations. The "filed rate doctrine"—*if* applicable to this dispute—is binding on the state courts. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 581-82 (1981).

Moreover, no interstate effect will be felt from the Council's retail level order. The Council has *not* refused to honor the FERC allocation; to the contrary, it has taken express action to ensure that NOPSI can continue to meet its obligations to its wholesale supplier. *See* Council's Brief at 7-8. The Rate Order has been in place for nearly ten months, and NOPSI has continued to meet its Grand Gulf obligations during that time. No costs have been shifted to other jurisdictions. The order was designed to ensure NOPSI's solvency and ability to pay its share of Grand Gulf costs.

Indeed, it is extraordinary that the Solicitor General has taken on the role of NOPSI's champion with

respect to a matter the company has declined to pursue on its own behalf: the need for preliminary injunctive relief from the federal courts to avoid allegedly irreparable injury even if "limited" abstention is appropriate (U.S. Br. at 14). NOPSI's brief to this Court did not raise this issue, and NOPSI has never asked the state court for such relief. NOPSI's motion for a preliminary injunction in the state judicial system was based on an asserted right to an injunction as a matter of *law* based on the doctrine of federal preemption and presented absolutely no showing of harm, irreparable or otherwise.

The Council does not deny that NOPSI is entitled to "its day in court" on its claims of federal preemption. The matter on which the litigants disagree is which judicial system—state or federal—properly should review such allegations in the first instance, particularly when issues of great local concern such as those embodied in the Council's Rate Order are at stake. In *NOPSI I*, this Court declined to review the federal court's decision to abstain in such circumstances. No different result is warranted here.

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In the Supreme Court of the United States

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NEW ORLEANS PUBLIC SERVICE, INC., PETITIONER

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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QUESTION PRESENTED

Whether a federal court should wholly abstain from adjudicating a claim, brought by a public utility against a local regulatory authority, that the authority is violating federal law by refusing to honor terms fixed by the Federal Energy Regulatory Commission for the interstate sale of electric power at wholesale.

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BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

This submission responds to the Court's invitation to the Solicitor General to file a brief expressing the views of the United States.

STATEMENT

1. Petitioner, New Orleans Public Service, Inc. (NOPSI), is one of four operating electric utility companies that are wholly-owned subsidiaries of Middle South Utilities, Inc. (MSU).[1] The other subsidiary companies, each of which

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[1] This Court's decision last Term in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), arose out of the same transactions underlying the instant dispute; those transactions are described more fully in the Court's opinion in that case. See slip op. 1-9.

sells electric power at retail to its own local customers, are Louisiana Power & Light (LP&L), Mississippi Power & Light Company (MP&L), and Arkansas Power & Light Company (AP&L). A generating subsidiary, Middle South Energy (MSE), was formed to own and finance two nuclear power plants, Grand Gulf 1 and 2, and to sell power from those plants to the operating companies.

In June 1985, the Federal Energy Regulatory Commission (FERC) approved wholesale rates for power from Grand Gulf 1 and allocated its capacity and energy among the four operating companies. See *Middle South Energy, Inc.*, 31 F.E.R.C. ¶ 61,305, on reh'g, 32 F.E.R.C. ¶ 61,425 (1985), aff'd *sub nom. Mississippi Indus.* v. *FERC*, 808 F.2d 1525, reh'g granted and vacated in part, 822 F.2d 1104, 1105 (D.C. Cir.), cert. denied, No. 86-1380 (Dec. 14, 1987).[2] FERC rejected the New Orleans City Council's contention that NOPSI's share of Grand Gulf 1 costs should be 9 percent (see Pet. App. 30A-31A n.11; Br. in Opp. 4-5 n.4). FERC instead concluded that the operating companies should share in the system's total investment in nuclear capacity "roughly in proportion to each company's share of System demand" (31 F.E.R.C. at 61,655-61,656). FERC ordered the following allocation of Grand Gulf 1 costs: AP&L, 36 percent; LP&L, 14 percent; MP&L, 33 percent; and NOPSI, 17 percent (*ibid.*). MSE has accordingly billed NOPSI for 17 percent of the costs since Grand Gulf 1 went into service on July 1, 1985.

The City Council of New Orleans regulates NOPSI's retail rates. On May 17, 1985, NOPSI applied for a retail

[2] The District of Columbia Circuit remanded the case to FERC to consider issues relating to the correctness of its allocation of certain Grand Gulf 1 costs. See 822 F.2d 1104. On remand, FERC reaffirmed, with further explanation, its prior allocation. See *System Energy Resources, Inc.*, 41 F.E.R.C. ¶ 61,238 (1987), appeal pending, No. 88-1067 (D.C. Cir.).

rate increase to reflect the Grand Gulf 1 costs that it would be required to pay under the FERC allocation. The instant case is the third in a series of lawsuits that NOPSI has brought in federal district court against the Council of the City of New Orleans, based on the Council's refusal to allow NOPSI to recover its Grand Gulf 1 costs in its retail rates.

2. a. *NOPSI I*: On July 17, 1985, the Council announced a public hearing, to be held on July 25, 1985, to consider whether interim rate relief for NOPSI was warranted (Res. R-85-423). The Council stated that the issue of interim rate relief needed to be addressed because "various factors, including questions as to the legality and prudency of the [contracts relating to Grand Gulf 1], the prudency and reasonableness of the said expenses, and lack of information on certain relevant matters, prevent the Council from either denying or granting the requested rate relief at the present time" (*ibid.*).

On August 2, 1985, NOPSI filed a complaint in federal district court seeking declaratory and injunctive relief, and money damages (86-546 Pet. App. 37A). NOPSI asked the court, inter alia, to issue preliminary and permanent injunctions enjoining the Council from denying NOPSI recovery, through its retail rates, of its FERC-allocated share of the expenses of Grand Gulf 1. The Council denied NOPSI's request for interim rate relief on September 5, 1985 (Res. R-85-5261).

On September 16, 1985, the district court granted the Council's motion to dismiss. *NOPSI* v. *City of New Orleans*, No. 85-3398 (E.D. La.). The court held that dismissal was warranted under the Johnson Act, 28 U.S.C. 1342, and under *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943). *Burford* abstention was appropriate, the court explained, because NOPSI's rate increase was a matter of local concern requiring local administrative expertise and

because the Council's actions would not directly conflict with FERC's order.

While the district court's ruling was pending on appeal, the Council and NOPSI entered into a settlement agreement with respect to the treatment of Grand Gulf 1 costs (Res. R-86-112). The agreement set out in detail the amounts by which NOPSI could increase its rate base annually until the costs of Grand Gulf 1 were fully recovered. Pursuant to the agreement, NOPSI also agreed permanently to absorb $51.2 million of the costs (*id.* at 4). Both sides purported to reserve their legal rights, including the Council's right to investigate the issue of prudence (*id.* at 11-12).

On appeal, the court of appeals initially reversed both aspects of the district court's ruling,[3] but on its own motion for reconsideration subsequently reversed itself on the abstention issue. See *NOPSI* v. *City of New Orleans*, 782 F.2d 1236, modified, 798 F.2d 858 (5th Cir. 1986), cert. denied, 481 U.S. 1023 (1987). The court concluded that *Burford* abstention was appropriate because "the regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise" (798 F.2d at 862). The court also held that abstention was appropriate under *Younger* v. *Harris*, 401 U.S. 37 (1971), because there was an ongoing administrative proceeding before the Council: "NOPSI would have a full and fair opportunity to litigate its federal

[3] See *NOPSI* v. *City of New Orleans*, 782 F.2d 1236 (5th Cir. 1986). The court concluded that the Johnson Act did not apply because NOPSI's request for injunctive relief rested on a "statutorily-based preemption claim" and therefore did not rest solely on the " 'repugnance of the order to the Federal Constitution,' " within the meaning of the Johnson Act (782 F.2d at 1242, quoting 28 U.S.C. 1342)). The court similarly concluded that *Burford* abstention was inappropriate where, as in this case, "the claim presented is predicated upon federal preemption" (782 F.2d at 1243).

claims" through the state appellate process, and there were no exceptional circumstances, such as bad faith or harassment, that rendered abstention improper (798 F.2d at 864).

NOPSI petitioned for a writ of certiorari, and, in response to this Court's invitation in a case raising a related issue (see *American Elec. Power Co.* v. *Kentucky Pub. Serv. Comm'n*, cert. denied, 481 U.S. 1023 (1987)), the United States and FERC filed a brief as amici curiae urging the Court to grant NOPSI's petition. Although we noted in our submission that the case was "blemished by procedural problems" because of the settlement agreement entered into between NOPSI and the City Council (86-49 U.S. Br. 23), we contended the abstention issue remained sufficiently concrete to warrant review. The Court, however, denied NOPSI's petition.

b. *NOPSI II*: While *NOPSI I* was pending before the court of appeals, the Council announced on October 10, 1985, that it would conduct a prudence investigation into NOPSI expenditures on Grand Gulf 1 and requested that NOPSI answer a lengthy series of questions posed by the Council (Res. R-85-636). On November 11, 1985, NOPSI filed a second lawsuit in federal district court in which it sought to enjoin the investigation. NOPSI subsequently amended its complaint to seek an injunction or a declaratory judgment only to the extent that the Council proposed taking any action to require NOPSI or its shareholders to absorb all or a portion of the cost of Grand Gulf 1 allocated to NOPSI by FERC.

The district court dismissed NOPSI's complaint. See *MSE* v. *Council of New Orleans*, No. 85-5273 (E.D. La. Dec. 18, 1986). The court ruled, first, that NOPSI's claims were not ripe because it was not clear whether the Council intended to proceed in a manner contrary to federal law. The court next ruled, in the alternative, that both *Younger* and *Burford* abstention were appropriate.

On appeal, the court of appeals affirmed. See *NOPSI* v. *Council of New Orleans,* 833 F.2d 583 (5th Cir. 1987). The court recognized that the Council's prudence investigation could "certainly be interpreted as directed towards areas now off-limits to state regulators" (*id.* at 586). The court nonetheless concluded that NOPSI's request for an injunction was not ripe because the Council's inquiry presented "only a possibility of harm to NOPSI. If such harm occurs, the validity of the New Orleans City Council's action will depend on facts not yet in existence" (*id.* at 588). NOPSI would suffer no irreparable injury, the court explained, pending completion of the Council's prudence inquiry (*ibid.*). The court of appeals did not address the district court's abstention ruling.

c. *NOPSI III*: On February 4, 1988, the Council issued a rate order based on its completed prudence inquiry. The Council found: (1) "NOPSI's oversight and review of its Grand Gulf obligation was uncritical and severely deficient"; (2) "NOPSI made no effort to reduce its risk exposure in the wake of the Three Mile Island Nuclear incident in 1979-80, which demonstrated the risks of operating a nuclear reactor"; and (3) "NOPSI imprudently failed to reduce the risk of its Grand Gulf commitment by selling a portion of its share of the power off-system, that is, to some other user." Pet. App. 8A. Based on these findings, the Council disallowed $135 million of NOPSI's deferred Grand Gulf costs and required NOPSI to deduct that amount from its rate base (*id.* at 24A). In order to reflect the disallowance, the Council also reduced rate increases then planned for NOPSI (*ibid.*). The Council explained, however, that the amount disallowed did not reflect the full extent of NOPSI's imprudence, because that amount would have caused NOPSI to become insolvent (*id.* at 9A). The Council had instead disallowed only that amount—minus an additional ten percent "buffer"—that it concluded NOPSI could absorb without becoming insolvent (*ibid.*).

NOPSI subsequently filed the instant action in federal district court, seeking a declaratory judgment and both preliminary and permanent injunctive relief from the Council's order.[4] NOPSI's complaint was based solely on federal grounds: its principal claim was that the order was preempted by federal law, and it contended that this claim fell within the exclusive jurisdiction of the federal courts under the Federal Power Act, 16 U.S.C. (& Supp. IV) 824 *et seq.*[5] NOPSI also argued that it would suffer irreparable harm absent preliminary injunctive relief because its inability to recover the $135 million in deferred Grand Gulf costs would reduce its common equity, eliminate its retained earnings, render it unable to sell rate recovery bonds, jeopardize its ability to continue to pay its FERC-mandated allocation of Grand Gulf costs, and make it unable to pay dividends on either preferred or common stock for at least five years.[6]

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[4] Upon the issuance of the City Council's order, the Council and a local consumer organization, the Alliance for Affordable Energy, filed separate lawsuits in state court. In a suit against NOPSI and others, the Council sought a declaration that the Council's order represented a just and reasonable exercise of the Council's power and that NOPSI's failure to comply with the order would be unlawful. See *Boissiere* v. *Cain*, No. 88-2503 (Civ. Dist. Ct. Parish of Orleans, La., filed Feb. 4, 1988). In a suit against the City Council, the Alliance for Affordable Energy sought an order directing the Council to disallow NOPSI's recovery of additional Grand Gulf costs. See *Alliance for Affordable Energy, Inc.* v. *Council of New Orleans*, No. 88-2502 (Civ. Dist. Ct. Parish of Orleans, La., filed Feb. 4, 1988). The City Council named NOPSI as a "defendant in reconvention" in the second lawsuit and NOPSI removed both cases to federal district court. Both cases were later remanded pursuant to that court's subsequent decision to abstain. See Pet. App. 27A & n.6.

[5] The complaint also alleged that the Council's actions violated the Commerce Clause and were barred by doctrines of estoppel.

[6] NOPSI also filed a complaint (petition of appeal) in state court. NOPSI's state court complaint sought relief based on several state law

On March 10, 1988, the federal district court dismissed NOPSI's complaint (Pet. App. 22A-33A). The court agreed with NOPSI that the Johnson Act does not preclude federal court jurisdiction over the lawsuit (*id.* at 25A-26A), but concluded that federal courts do not have exclusive jurisdiction under the Federal Power Act over NOPSI's federal preemption claim and that both *Burford*

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and federal constitutional grounds. NOPSI argued that the Council's rate order was unlawful under state law because it abrogated its settlement agreement with NOPSI, was not supported by substantial evidence in the record, and was based on an improper legal standard of prudence. NOPSI also argued that the order violated both the State and Federal Constitutions because it denied NOPSI due process and constituted a taking of property without just compensation. NOPSI's state law complaint, however, did not seek relief based on NOPSI's federal preemption claim. Nor did it seek preliminary injunctive relief. In a letter to the state court that accompanied its state court filing, NOPSI notified the court of the pendency of its federal court lawsuit against the City Council and explained that it was filing with the state court in order to avoid later being barred by the applicable state limitations period. NOPSI also explained that it had not included its federal preemption claim because the federal courts had exclusive jurisdiction over that claim, but that it wished to reserve the right to include that count in its state complaint should the federal court subsequently dismiss NOPSI's federal lawsuit.

Following the federal district court's dismissal of NOPSI's action on abstention grounds, NOPSI amended its state court complaint to include a federal preemption argument and also filed a motion for preliminary injunctive relief based solely on its claim of federal preemption. The state trial court denied NOPSI's motion for preliminary relief on May 5, 1988, and NOPSI's appeal of that ruling is now pending before a state appellate tribunal, which denied NOPSI's request for expedited appeal. See *NOPSI* v. *Council of New Orleans*, No. 88-CA-1369 (4th Cir. La. Ct. App.). The parties to the state trial court proceeding have since filed cross-motions in support of petitions for review and/or summary judgment on the merits, which are pending before that court. Oral argument on those motions was held on November 30, 1988.

and *Younger* abstention were appropriate (*id.* at 26A-33A).

The court of appeals affirmed (Pet. App. 2A-20A). In examining the appropriateness of abstention, it assumed that NOPSI could prove "as it alleges, with some apparent evidentiary support," that the Council's order " 'is beyond the Council's retail ratemaking authority and violates federal law' " because the order "results in 'trapping' [of] FERC allocated costs," and "was based on factors that the state could not legally consider" (*id.* at 11A). The court of appeals concluded that its prior "opinion in *NOPSI I* nonetheless requires us to uphold the district court's decision to abstain" (*id.* at 20A).[7]

DISCUSSION

Two Terms ago, we urged the Court to grant review in *NOPSI I*.[8] We contended then that the Fifth Circuit's abstention ruling was incorrect, conflicted with decisions of other courts of appeals, and raised important issues of federal law warranting a grant of certiorari. We recognized that an intervening settlement agreement between the parties had diminished somewhat the concreteness of the controversy, but concluded, on balance, that plenary review was appropriate. NOPSI's current petition raises similar abstention issues, but without the mootness claims that plagued *NOPSI I*. Because we continue to believe that the Fifth Circuit has misapplied this Court's precedent in abstaining from deciding the merits of NOPSI's preemption claim, because a circuit conflict persists on the issue,

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[7] Like the district court, the court of appeals rejected NOPSI's argument that the Federal Power Act provides federal courts with exclusive jurisdiction over its preemption claim (see Pet. App. 11A-15A). That holding is not challenged in NOPSI's petition in this case.

[8] A copy of that earlier filing is attached to this brief.

and because additional matters of importance are raised on this record, we again urge the Court to grant further review.

1. The most recent decision of the Fifth Circuit in *NOPSI III*, like its prior decision in *NOPSI I*, is incorrect. "Abstention from the exercise of federal jurisdiction is the exception, not the rule." *Colorado River Water Conservation Dist.* v. *United States*, 424 U.S. 800, 813 (1976). In our view, neither *Burford* nor *Younger* abstention is appropriate where, as in this case, the utility makes a substantial claim that a local regulatory authority has improperly "trapped" costs allocated to it by FERC pursuant to FERC's exclusive jurisdiction over the terms of sale of power among members of an interstate utility system. The independent interest of any single state in such an inherently interstate controversy is not sufficient to justify denying the federal plaintiff the choice of a federal forum. Moreover, even if it is determined that limited abstention is warranted, the district court should at the very least be required to consider whether interim relief is necessary to prevent irreparable harm to federally protected interests.

a. In *Burford*, the Court concluded that it would be best to "leave • • • problems of [state] law to the state court" in that case because of the great harm to state policies that might result from federal court misinterpretation of state law concerning the development, production, and conservation of interstate oil and gas resources (319 U.S. at 332; see *id.* at 327, 329-330, 331 & n.28, 333-334).[9] This case, in contrast, concerns the scope of federal regulatory law and policy. The federal question whether a particular FERC allocation must be honored by a local regulatory authority in a particular context is, moreover, qualitatively different from the type of broad and amor-

[9] Indeed, the state courts were described as "working partners with the [state] Railroad Commission in the business of creating a [state] regulatory system for the oil industry" (319 U.S. at 326).

phous due process claims raised in *Burford* and *Alabama Pub. Serv. Comm'n* v. *Southern Ry.*, 341 U.S. 341, 347 (1951), which is the only case since *Burford* in which this Court has squarely upheld abstention on the basis of that decision.[10] In the present case, unlike those cases, any resulting disruption of state law or policy would be a deliberate result of an elaborate and comprehensive congressionally-enacted scheme. Congress determined that terms for the allocation of power and costs among members of a multistate public utility holding company should be conclusively resolved by a neutral federal administrative forum (FERC) in accordance with federal law. See *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), slip op. 16-17. Hence, *Burford* abstention is inappropriate in this class of cases because the underlying premise of abstention on that ground—the need to avoid disruption of state law or policy or to make determinations "predominantly local" in character—is missing. Cf. *Zablocki* v. *Redhail*, 434 U.S. 374, 379-380 n.5 (1978) ("there is, of course, no doctrine requiring abstention merely because resolution of a federal question may result in the overturning of a state policy"); *England* v. *Louisiana State Bd. of Medical Examiners*, 375 U.S. 411, 415-416 (1964) ("recognition of the role of state courts as the final expositors of state law implies no disregard for the primacy of the federal judiciary in deciding questions of federal law"); *Silverman* v. *Barry*, 727 F.2d 1121, 1123-1124 n.4 (D.C. Cir. 1984).

[10] In *Alabama Pub. Serv. Comm'n* v. *Southern Ry.*, a railroad sought to enjoin a state commission's refusal to permit discontinuance of two intrastate trains; the railroad argued there that the commission's order constituted an unconstitutional deprivation of its property. The Court's requirement of abstention was based on its conclusion that the correctness of the challenged order depended on "predominantly local factors" (341 U.S. at 349).

b. *Younger* abstention is also inappropriate. The most "vital consideration" prompting *Younger* abstention is the "notion of 'comity', that is * * * the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways" (401 U.S. at 44). See *Ohio Civil Rights Comm'n* v. *Dayton Christian Schools, Inc.*, 477 U.S. 619, 626-627 (1986); *Middlesex County Ethics Comm.* v. *Garden State Bar Ass'n*, 457 U.S. 423, 431 (1982); *Trainor* v. *Hernandez*, 431 U.S. 434, 441 (1977); *Juidice* v. *Vail*, 430 U.S. 327, 334 (1977); *Huffman* v. *Pursue, Ltd.*, 420 U.S. 592, 601 (1975). This notion—of allowing each state to perform its separate function—loses much of its force, however, when, as in this case, the interests of several states are at odds because of their participation in a multistate "common pool"; in such a case, a decision by the tribunals of any one state in favor of its citizens may have a corresponding direct adverse effect on citizens of other participating states. See *Mississippi Indus.* v. *FERC*, 808 F.2d at 1548-1549; *Appalachian Power Co.* v. *Public Serv. Comm'n*, 812 F.2d 898, 904-905 (4th Cir. 1987); *Middle South Energy, Inc.* v. *Arkansas Public Serv. Comm'n*, 772 F.2d 404, 416-417 (8th Cir. 1985), cert. denied, 474 U.S. 1102 (1986).[11] Unlike the federal claims at issue in *Younger* and its progeny, therefore, the claims in such inherently interstate disputes are not readily susceptible to resolution by leaving states "free to perform their separate functions in their separate ways." [12]

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[11] The common pool may consist of shared benefits, as in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), or of shared burdens, as in this case and *Mississippi Power & Light Co.* See *Mississippi Power & Light Co.*, slip op. 18.

[12] For this same reason, there may also be some basis for questioning whether state fora can provide the unbiased decisionmaking upon

We do not contend that abstention is necessarily undesirable whenever a federal plaintiff raises a federal preemption claim. See *Lake Carriers' Ass'n* v. *MacMullan*, 406 U.S. 498, 511-512 (1972) (abstention on claims of federal unconstitutionality and federal statutory preemption was warranted because resolution of the federal questions presented was " 'dependent upon, or may be materially altered by, the determination of an uncertain issue of state law' "). But federal preemption claims, turning as they frequently do on an understanding of a complex federal regulatory scheme, are often not appropriate for the exercise of deference to state tribunals. See, *e.g.*, *Kentucky West Va. Gas Co.* v. *Pennsylvania Pub. Util. Comm'n*, 791 F.2d 1111, 1116-1117 (3d Cir. 1986). Whether abstention is appropriate in a case involving a claim of federal preemption depends, among other things, on the relative significance of the preemption claim in the lawsuit, on its relation to issues of state law, and on the nature of the preemption argument. In our view, all of these factors render abstention inappropriate in this case. The preemption claim is dispositive of the merits of the lawsuit and, as described above, the nature of the preemption argument deprives the considerations underlying *Younger*, particularly the notion of comity, of substantial force. Cf. *Western Air Lines* v. *Board of Equalization*, 480 U.S. 123, 129-130 (1987) ("The general principle that * * * the meaning of words in a federal statute is a question of federal law has especial force when the purpose of the federal statute is to eliminate discriminatory state

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which *Younger* abstention is predicated. Cf. *Gibson* v. *Berryhill*, 411 U.S. 564, 577 (1973). The City Council, for instance, is a popularly elected legislative body. When setting rates, its proceedings are not judicial; they are "essentially a legislative function." *Colorado Interstate Gas Co.* v. *Federal Power Comm'n*, 324 U.S. 581, 589 (1945); see also *Permian Basin Area Rate Cases*, 390 U.S. 747, 776 (1968).

treatment."); *Hagans* v. *Lavine*, 415 U.S. 528, 550 (1974) (quoting *United Mine Workers* v. *Gibbs*, 383 U.S. 715, 729 (1966) (" 'the federal courts are particularly appropriate bodies for the application of pre-emption principles' ").

Finally, contrary to the Council's claim (Br. in Opp. 3, 23), this Court's decision in *Pennzoil Co.* v. *Texaco, Inc.*, No. 85-1798 (Apr. 6, 1987), does not suggest otherwise. The Court in *Pennzoil* denied that it was "hold[ing] that *Younger* abstention is always appropriate whenever a civil proceeding is pending in a state court" (slip op. 11 n.12). Abstention was appropriate in *Pennzoil*, the Court explained, only because it was needed to protect the "vital" state interest in enforcing the orders and judgments of state courts. The federal injunction sought in *Pennzoil* would have interfered with the execution of state court judgments and "would do so on grounds that challenge the very process by which those judgments were obtained" (slip op. 11). No comparable state interest is implicated in this case. Nor is the constitutional issue here—essentially a question of the preemptive effect of a federal statute under the Supremacy Clause—comparable to the Fourteenth Amendment due process claim that the decision in *Pennzoil* sought to avoid.

c. For all these reasons, we believe that abstention in this case is not warranted and that NOPSI's choice of a federal forum should be sustained. If it is determined, however, that limited abstention is appropriate, an important question is presented by NOPSI's request in this action for *preliminary* injunctive relief. That request, based solely on a claim of irreparable injury to a protected federal interest, should be entertained by the district court. If, as NOPSI claims, the denial of interim relief may, as a practical matter, result in the permanent trapping of costs and thus in the frustrating of federal policy, then such relief is necessary to vindicate that policy. At the same

time, the granting of interim relief would not, in itself, interfere with the ability of state tribunals to decide NOPSI's claims on their merits. It would only prevent the infliction of irreparable harm in the meantime.[13] In related contexts, this Court and lower courts have previously recognized or endorsed the appropriateness of a limited form of abstention, coupled with preliminary relief, in order to avoid irreparable harm. See, *e.g.*, *Babbitt* v. *United Farm Workers*, 442 U.S. 289, 312 n.18 (1979) ("[T]his is a matter best addressed by the District Court in the first instance."); *Romany* v. *Colegio de Abogados de Puerto Rico*, 742 F.2d 32, 45 n.13 (1st Cir. 1984); *Spartacus, Inc.* v. *Borough of McKees Rocks*, 694 F.2d 947, 949 & n.3 (3d Cir. 1982); *Catrone* v. *Massachusetts State Racing Comm'n*, 535 F.2d 669, 672 (1st Cir. 1976); *Cox Cable Communications, Inc.* v. *Simpson*, 569 F. Supp. 507, 515-522 (D. Neb. 1983); cf. *Fujikawa* v. *Gushiken*, 823 F.2d 1341, 1347 (9th Cir. 1987). See also P. Bator, D. Meltzer, P. Mishkin & D. Shapiro, *Hart & Wechsler's The Federal Courts and the Federal System* 1375, 1422-1423 (3d ed. 1988); Laycock, *Federal Interference with State Prosecutions: The Need for Prospective Relief*, 1977 Sup. Ct. Rev. 193, 277-278; Wells, *Preliminary Injunctions and Abstention: Some Problems in Federalism*, 63 Cornell L. Rev. 65 (1977).

2. Further review is also warranted because the abstention issues are important and are the subject of a conflict in the circuits.

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[13] As noted above (see note 6, *supra*), the state court denied NOPSI's request for preliminary relief and for an expedited appeal.

The question of preliminary relief in the present case is, of course, different from the question presented in *Pennzoil*. In that case, Texaco's entire federal claim was that it was constitutionally entitled to a stay of the trial court's judgment pending appeal; a federal court decision in Texaco's favor would have disposed of the very issue held appropriate for abstention.

a. At the time we filed our submission in *NOPSI I*, there was a conflict involving five circuits on the question of abstention. That conflict has persisted and, as before, is most starkly presented by comparing the opinions of the Third, Fifth, Sixth, and Eighth Circuits on the propriety of *Younger* abstention in cases raising preemption claims based on the "filed rate doctrine." [14] The Sixth Circuit, like the Fifth Circuit, has ruled in favor of *Younger* abstention (see *American Elec. Power Co.* v. *Kentucky Pub. Serv. Comm'n*, 787 F.2d 588 (1986), cert. denied, 481 U.S. 1023 (1987)),[15] but the Third and Eighth Circuits have rejected both *Burford* and *Younger* abstention (see *Kentucky West Va. Gas Co.* v. *Pennsylvania Pub. Utility Comm'n*, 791 F.2d 1111 (3d Cir. 1986); *Middle South Energy, Inc.* v. *Arkansas Pub. Serv. Comm'n*, 772 F.2d 404 (8th Cir. 1985), cert. denied, 474 U.S. 1102 (1986).[16]

[14] As described by this Court in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 962 (1986), the filed rate doctrine "holds that interstate power rates filed with FERC or fixed by FERC must be given binding effect by state utility commissions determining intrastate rates."

[15] The per curiam opinion for the Sixth Circuit in *American Electric Power* is unpublished. The court of appeals held that *Younger* abstention was required but that *Burford* abstention was not. Curiously, however, two judges of the three-judge panel sitting in that case filed separate concurring opinions in which each contended that *Burford* abstention was required.

[16] The preemption claim in *Middle South Energy, Inc.*, like the preemption claim in this case, arose out of FERC's allocation of the costs of the Grand Gulf I nuclear power facility; it involved the efforts of a state public service commission to shield the citizens of Arkansas from absorbing AP&L's FERC-allocated share of those costs.

Two Fourth Circuit decisions, both of which also involve the propriety of abstention in cases raising preemption claims based on the filed rate doctrine, further illustrate the scope of the current circuit conflict. In *Aluminum Co. of America* v. *Utilities Comm'n*, 713 F.2d 1024, 1030 (1983), cert. denied, 465 U.S. 1052 (1984)), the Fourth Circuit upheld abstention on *Burford* grounds after concluding that evaluation of plaintiff's claim—that the state commission's establishment of retail, intrastate rates conflicted with FERC-approved wholesale interstate rates—would require detailed factual inquiry. The court of appeals suggested, however, that abstention would not be appropriate in a case where the conflict between state and federal law was direct and clear (*ibid.*). In an action presumably based upon that caveat, the Fourth Circuit subsequently affirmed a district court's denial of both *Younger* and *Burford* abstention in the context of a preemption claim more akin to that present in this case (see *Appalachian Power Co.* v. *Public Serv. Comm'n*, 614 F. Supp. 64 (S.D. W. Va.), aff'd, 770 F.2d 159 (4th Cir. 1985), on remand, 630 F. Supp. 656 (S.D. W. Va. 1986), aff'd, 812 F.2d 898 (4th Cir. 1987)).

There is no merit, moreover, to respondents' contention (Br. in Opp. 13 (emphasis in original)) that a circuit conflict does not exist because "all the circuits that have considered the issue (including the Fifth Circuit) appear to agree • • • that they will not hesitate to exercise jurisdiction where the state and federal actions are in *direct* conflict and that conflict is readily discernible from the pleadings." Both the Sixth Circuit's decision in *American Elec. Power* and the Fifth Circuit's ruling in this case involved allegations of just such a direct conflict between federal and state law. Indeed, the Fifth Circuit in its decision below expressly assumed that the district court had

abstained even though "that [which] was not clear when *NOPSI I* was decided is now clear: the [Council's] Rate Order results in 'trapping' FERC allocated costs * * * [,] was based on factors that the state could not legally consider[,] and consequently * * * 'is beyond the Council's retail ratemaking authority and violates federal law' " (Pet. App. 11A).[17] Significantly, moreover, the Fifth Circuit, unlike respondents, readily acknowledged that a widespread circuit conflict exists on the propriety of abstention in these circumstances (see *id.* at 15A, 20A). Only respondents refuse to acknowledge the obvious.

b. We also continue to believe that the abstention issues are important. The circumstances that have given rise to the plethora of lower court decisions are likely to

[17] For this reason, respondents' effort (Br. in Opp. 24-27) to argue the merits of NOPSI's preemption claim is misguided. Whether a circuit conflict is presented depends on the court of appeals' reasoning, not respondents'. Both the court of appeals' and district court's opinions strongly suggest, moreover, that neither found much force in respondents' preemption arguments. As described by the district court (Pet. App. 30A), "the Council faults NOPSI not for buying a 'pig in a poke' but for failing to find a sucker to buy it when the faux-pas became apparent." The court added that it "is not ready to assume there are many, if any, such suckers purchasing electricity in the wholesale market today" (*id.* at 30A n.11). Finally, the district court commented on the Council's selection of "a figure of 8% for the prudence disallowance," explaining that "the Council, and in this case, everyone else knows that the 8% figure * * * represents the difference between FERC's 17% allocation and what NOPSI consistently claims as its relative share in the MSU system, i.e., 9%. Thus, the disallowed costs bear no apparent relationship to the savings NOPSI is said to have foregone" (*id.* at 30A-31A n.11).

Similarly, the court of appeals concluded that "the language of [the Supreme Court's opinion in *Mississippi Power & Light Co.*] seems to foreclose" the Council's inquiry into "NOPSI's asserted imprudence in failing to resell the power it had agreed to, and is now bound by the FERC order to, buy" (Pet. App. 13A).

persist. Utilities in neighboring states will continue to affiliate and enter into joint financing and power sharing arrangements in order to construct the more massive power production facilities necessary to meet increased demand. And, as happened with Grand Gulf 1, cost overruns and lower than predicted energy demand will sometimes strain those arrangements and continue to produce the type of interstate dispute that underlies the controversy presented in this case.

Resolution of the abstention issues also continues to be especially important to a fair resolution of these interstate disputes. As *NOPSI I* vividly illustrated, a utility's liability for wholesale rates may be immediate and ongoing, and a delay in passing those costs through in retail rates will often have consequences that are irreparable; it may create immediate cash flow problems and uncertainties that may threaten bankruptcy, impede securities offerings, and force compromise settlements (see pages 4, 7, *supra*). Because abstention, especially without consideration of appropriate preliminary relief, may contribute to, and even precipitate, this result, respondents' argument (Br. in Opp. 25), that this Court may determine the merits of the preemption claim on review of the decisions of the state tribunals, rings hollow.

3. Finally, this case presents an excellent vehicle for addressing the abstention issues. It is not blemished by the procedural problems present in *NOPSI I* because the settlement agreement entered into between the parties, which diminished the concreteness of the controversy in *NOPSI I,* is wholly incidental to this lawsuit. That agreement purported to preserve the Council's right to disallow NOPSI's right to recover certain Grand Gulf costs on the ground that they were imprudently incurred (see page 4, *supra*). This case concerns the lawfulness of the Council's exercise of that right.

The presence in this case of parallel state judicial proceedings does not render further review inappropriate (see note 6, *supra*). To be sure, those parallel proceedings suggest arguments of comity that were not present in *NOPSI I*. Moreover, the state courts may determine the merits while the federal proceedings are pending, possibly injecting issues of res judicata into any future federal court consideration of the preemption question. See *Huffman* v. *Pursue, Ltd.*, 420 U.S. at 607-608 & n.19; see also *Kremer* v. *Chemical Constr. Co.*, 456 U.S. 461 (1982). The parallel state proceedings do not, however, change our views on the impropriety of federal abstention in this case and, more important, need not prevent this Court from addressing the fundamental question whether, at the time of the federal district court's decision, total abstention was appropriate. See *Pennzoil Co.* v. *Texaco, Inc.*, slip op. 15 ("In this opinion, we have addressed the situation that existed on the morning of December 10, 1985, when this case was filed in the United States District Court for the Southern District of New York."). Any issues of res judicata that may arise after that time may properly be addressed on remand.

Indeed, were the rule otherwise, the opportunity would seldom if ever arise for Supreme Court review of an abstention ruling in a case such as this. For, as long as the abstention issue remains unsettled, a federal plaintiff will, as in this case, be compelled to initiate a parallel state court proceeding in order to protect itself against the possibility of federal court abstention after the applicable state limitations period has run. We do not believe that action that a plaintiff must take in order to preserve its right to seek relief in some forum should deprive that plaintiff of the ability to seek Supreme Court review of its choice of a federal court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.*
Respondents.

On Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

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The Opinion of the Court of Appeals is set out in the Appendix to the Petition for Certiorari at 1A-20A.

The Opinion and Order of the District Court is set out in the Appendix to the Petition for Certiorari at 21A-33A.

The Judgment of the Court of Appeals is set out in the Appendix to the Petition for Certiorari at 35A.

U.S. COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Case Number 88-3194

Circuit 5 Appeal from
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NEW ORLEANS PUBLIC SERVICE INC.,
Plaintiff-Appellant,

versus

THE COUNCIL OF THE CITY OF NEW ORLEANS,
JOSEPH I. GIARRUSSO, LAMBERT C. BOISSIERE, JR.,
MICHAEL EARLY, JAMES N. SINGLETON,
DOROTHY MAE TAYLOR, JOHNNY JACKSON,
and PEGGY WILSON,
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RECORD, EXHIBITS AND BRIEF INFORMATION

Date	Filing
3/24/88	Record on Appeal—2 Vols.
3/24/88	Exhibits-1 Box
6/15/88	Exhibits-3 Boxes
4/13/88	Records Excerpts—Appellant
3/24/88	Briefing Notice Issd.
4/13/88	Brief for Appellant—due 4/13
5/3/88	Brief for Appellee (J) (Corrected)
5/13/88	Reply Brief for Appellant (J) due 5/13
6/6/88	Rule 28(j) letter—Appellant (J)
5/10/88	Rule 28(j) letter—Appellee(J)
6/28/88	Rule 28(j) letter—Appellant(J)
7/1/88	Rule 28(j) letter—Appellee(J)
7/1/88	Rule 28(j) letter—Appellant(J)
7/7/88	Rule 28(j) letter—Appellee(J)

MISCELLANEOUS FILING

3/22/88	Dup. Notice of Appeal and Clerk's Statement of Docket Entries

EXTENSION

Expedited—No extensions

CALENDAR INFORMATION

Date	Proceeding
4/29/88	Case Assigned for 6/8/88 in EB Hearing Panel: ABR-RGG-EHJ
6/8/88	Case Argued by Appellant and Appellee

OPINION INFORMATION—PUBLISHED

7/28/88	ABR Affirmed—Signed-Yes

MOTIONS

3/22/88	Injunction Pending Appeal & Expedite Response Filed By—City Date—3/30/88 Denied—S9 By Court Date—4/6/88

OTHER DOCKET ENTIRES

Date	Proceeding
3/31/88	Flg. appellant's ltr. dtd. 3/31/88 in response to misstatements in Memo in opposition to motion to injunction pending appeal, etc.
4/5/88	Flg. ltr. dtd. 4/4/88 from appellee objecting to ltr. of cnsl. for NOPSI. (sub. via Rapicom-4/5/88)
4/6/88	Flg. Order DENYING appellant's mot. for injunction pending appeal. Further GRANTING appellant's mot. to expedite appeal, the Clerk is directed to place appeal on next available oral arg. dkt. (HAP, SDJ, PEH)

5/26/88	Flg. ltr. dtd. 5/25/88 from appellees' cnsl. enclosing copies of pg. 32 of brief which was missing from their set, and calling to Court's attention error in footnote 6 on page 7. (J)
6/10/88	Flg. ltr. dtd. 6/9/88 from Cnsl. Vince supplementing oral arg. (J)
6/10/88	Flg. ltr. dtd. 6/10/88 from Cnsl. Abbott supplementing oral arg. (J)

JUDGMENT OR MANDATE INFORMATION

7/28/88	Flg. & Entg. Judgment
8/19/88	Jdgt. as Mdt. Issd. to Clerk
8/19/88	Record on Appeal Retd. to Clerk (2 vols)
8/19/88	Exhibits Retd. to Clerk 4 Boxes

SUPREME COURT INFORMATION 88-348

9/2/88	Notice of Flg. of Cert. Pet. on 8/26/88
1/11/89	Order of S.C.—Granted 1/9/89

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

88-00559

NEW ORLEANS PUBLIC SERVICE INC.,
Plaintiffs,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, LAMBERT BOISSIERE, JR., MIKE EARLY, JOSEPH I. GIARRUSSO, JOHNNY JACKSON, JR., JAMES SINGLETON and DOROTHY MAE TAYLOR,
Defendants.

District—053L
Off.—2
Docket No.—Yr. 88 Number 00559
OR—1
Filing Date—Mo. 2 Day 9 Yr. 88
J—3
Nature Suit—890
Judge—3L24
Mag.—3LBB
MDL Docket—3L21

ADDITIONAL DEFTS CONTINUED

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PEGGY WILSON

DATE	NR.	PROCEEDINGS
2/9/88	1	Complt, 8 sms issd.
2/9/88	2	Pltf's MTN & ORDERED that Council of City of New Orleans show cause on 3/2/88 at 10:00 am why prelim injunction should not issue. (AJMc) 2/11/88 DKTD 2/12/88.
2/9/88	3	Pltf's ntc of related case 85-5273 D & 85-3398D.
2/9/88	4	ORDERED that matter is TRANSFERRED to Section "D" (2). (GA Jr) 2/9/88 dKTD 2/12/88.
2/12/88	5	M.E. 2-12-88; Phone Conf. held; HRG. on the Mtn. for Prel. Injunction set for 3/2/88 at 10:00; BY5:00 on 2/23/88, counsel for deft. to file any Mtns. to Remand Companion lit. that has been removed to this ct by NOPSI. By Noon on 2/24/88, counsel for deft. to file any Mtns. to dism complt w/ any reply Memoranda to the req. for Inj. Relief. By 2/29/88 at Noon, NOPSI to file Opo. Memo. to the Mtns. to Remand, Opo. Memo. to Mtns. to Dism and Reply Memo. concerning the Prel. Injunct. (AJM) dktd. 2-12-88
2/24/88	6	Mtn. by defts' to Dism.
2/29/88	7	Pltf's Memo. in Opo. to Mtn to Dism. and for Remand.
3/1/88	8	Mtn. by defts' & ORDERED that Clinton Vince, Bernhardt Wruble, Glen Ortman and Nancy Wodka are permitted to appear as co-counsel. (AJM) 3-1-88 dktd. 3/3/88.

3/2/88	9	M.E. 3/1/88; Hrg. set for 3-2-88 is CANCELLED. Addit'l deps will be taken March 2, 3 or 4, 1988, and all deps. and any other memranda will be subm. to ct by 12:00 Noon on Saturday, March 5, 1988. The pending Mtns. will then be considered by the Ct. on documents w/out oral arguments. (AJM) dktd. 3-3-88.
3/8/88	10	Reply Memo. by defts' in support of their Mnt. oto Dism.
3/8/88	11	Pltf's Mtn. & ORDERED that same have leave to file Supple Memo. in Support of Mtn. for Prel. Injunction. (AJM) 3-9-88 dktd. 3-10-88.
3/9/88	12	Pltf's Supple Memo. in Support of Mnt. for Prel. Injunct.
3/10/88	13	OPINION & ORDER: that Council's Mtn. to Dism is GRANTED and Pltf's Complt be DISM. w/out prej (AJM) 3-10-88 dktd. 3-11-88.
3/10/88	14	JUDGMENT: ORDERED in favor of Defts' and agnst. Pltf. dism. pltf's complt w/out prej. and for costs (AJM) 3-10-88 dktd. 3-11-88.
3/10/88	15	Pltf's depo of John L. Cowan on 3/2/88.
3/10/88	16	Pltf's depo of Edward A. Cecil on 3/3/88.
3/10/88	17	Pltf's depo of David L. Quivey on 3/2/88.
3/10/88	18	Pltf's depo of Malcolm H. McLetchie on 3/3/88.
3/21/88	19	Pltf's Ntc. of Appeal of judgment entered on 3-10-88.
3/22/88	xx	Notice of Appeal forwarded to all parties. (dlm)

3/21/88	20	Pltf's Mtn. for Exped. Hrg. on Mtn. for Inj. Pend. Appeal—ORDERED Exped. Hrg. held by Phone Conf. & Mtn. for Injunct. is DENIED. (AJM) 3-21-88 dktd. 3-23-88.
3/22/88	21	Pltf's Mtn. for Injunction Pending Appeal.
3/23/88	xx	Record forwarded to Court of Appeals. (dlm)
4/11/88	22	(5TH CIRCUIT ORDER) ORDERED that pltf's mtn for injunction pending appeal is DENIED; that pltf's mtn to expedite appeal is GRANTED, Clerk directed to place appeal on next available oral argument docket. (POLITZ, JOHNSON & HIGGINBOTHAM)
8/22/88	xx	Record returned from Ct of Appeals. (JMD)
8/22/88	23	(5th Cir) ORDERED that the judg. of the dist. ct. is AFFIRMED; FURTHER ORDERED that pltf-appellant pay to defts-appellees the costs on appeal to be taxed by Clerk of Ct. Issd. as Mandate 8-19-88.

IN THE MATTER OF EX PARTE APPLICATION OF NEW ORLEANS PUBLIC SERVICE INC. FOR AN INCREASE OF ITS ELECTRIC RATES (DOCKET NO. CD 85-1)

PRUDENCE INVESTIGATION: DETERMINATIONS AND ORDER REGARDING THE PRUDENCE OF THE MANAGEMENT OF NEW ORLEANS PUBLIC SERVICE INC. WITH RESPECT TO GRAND GULF I

COUNCIL OF THE
CITY OF NEW ORLEANS

Dorothy M. Taylor
Joseph I. Giarrusso
Lambert Boissiere, Jr.
Mike Early
Johnny Jackson, Jr.
James Singleton
Peggy Wilson

The Foregoing is Certified To Be A True and Correct Copy

/s/ Emma Williams
Clerk of Council
City of New Orleans

Date: February , 1988

/s/ Lambert Boissiere, Jr.
/s/ Peggy Wilson
/s/ James M. Singleton
/s/ Mike Early
/s/ Johnny Jackson
/s/ Joseph I. Giarrusso

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CITY HALL: _____

BY: COUNCIL MEMBERS TAYLOR, GIARRUSSO, BOISSIERE, EARLY, JACKSON, SINGLETON AND WILSON

IN THE MATTER OF EX PARTE APPLICATION OF
NEW ORLEANS PUBLIC SERVICE INC.
FOR AN INCREASE OF ITS ELECTRIC RATES
(DOCKET NO. CD 85-1)

PRUDENCE INVESTIGATION: DETERMINATIONS AND ORDER

I. INTRODUCTION

The Council has undertaken an investigation of the prudence of the management of New Orleans Public Service Inc. ("NOPSI") with respect to NOPSI's involvement in the Grand Gulf Unit No. 1 nuclear-fueled electric generating station ("Grand Gulf I"), which is part of a larger project involving a second unit ("Grand Gulf II"). This investigation is an outgrowth of the ratemaking proceeding initiated by NOPSI's filing of an application with the Council on May 17, 1985 for a rate increase to reflect its share of the costs of Grand Gulf I. It was formally instituted by Resolution R-85-636, adopted October 10, 1985.

A. Authority of the Council

The Council has conducted this prudence investigation under its authority as regulator of NOPSI's rates and operations. Pursuant to Section 4-1604 of the Home Rule Charter of the City of New Orleans, the Council is invested with "all powers of supervision, regulation and control over any street railroad, electric, gas, heat, power, waterworks, and other public utilities within the City of New

Orleans."[1] The Council's regulatory power is recognized by the Louisiana Constitution of 1974, which excludes from the authority of the Louisiana Public Service Commission ("LPSC") a public utility otherwise regulated by a political subdivision of the state. La. Const. Art. 4, Section 21(b) and (e).

NOPSI's rights and obligations with respect to the provision of electric service in New Orleans derive from a series of events and enactments beginning in 1921. The Louisiana Constitution of 1921 granted to the City of New Orleans the right and authority to "perform all of the acts pertaining to its local affairs, property and government, which are necessary or proper in the legitimate exercise of its corporate power and municipal functions." La. Const. of 1921, Art. 14, Section 22. Also in 1921, the Louisiana legislature authorized certain cities, including New Orleans, to grant franchises to public utilities and to regulate them. The pertinent statute, La. Rev. Stat. Ann. § 33:4405, read in part:

> The governing authority of every city having a population of one hundred thousand or more may grant indeterminate permits for the use of the streets and other public places in connection with the operation and maintenance of any public utility . . . . [and] may prescribe, stipulate, or agree to such other conditions of the permits as it deems proper. Any violation of any of the conditions shall be sufficient grounds for forfeiture of the permit, in which event or for other legal

[1] With the exception of a brief period, the Council has exercised regulatory jurisdiction over NOPSI since 1922. On November 23, 1981, pursuant to Ordinance No. 8264 (adopted by the Council on August 6, 1981), a referendum of the voters caused regulatory authority over NOPSI to be transferred to the Louisiana Public Service Commission ("LPSC"). Such powers were returned to the Council by a referendum of the voters on May 4, 1985. Formal transfer of powers from the LPSC to the Council took place on May 15, 1985.

> cause, the city may sue for its forfeiture, cancellation, or revocation or, at its option, may sue for its enforcement with damages suffered . . .

Before the creation of NOPSI, the New Orleans Railway & Light Company provided electric service to the City of New Orleans. On April 21, 1922, the Commission Council of the City of New Orleans, in connection with the reorganization of the latter company, passed Ordinance No. 6822, which set forth the terms and conditions under which NOPSI was to be franchised. Among the conditions was the requirement that the Commission Council "will at all times require the properties to be efficiently and economically managed and operated." Ord. No. 6822, Sec. 2.

On September 2, 1922, the Commission Council enacted Ordinance No. 7068, which officially enfranchised NOPSI. Under the terms and conditions of that ordinance, NOPSI was "entitled and authorized to charge and collect such fair and reasonable rates for electrical energy furnished and delivered in the City of New Orleans as may be established by the City of New Orleans and/or other regulatory authority in accordance with law." Ord. No. 7068, Sec. 4. NOPSI's authority to operate and to collect rates thus derives entirely from the acts and authority of the City Council and its predecessor, the Commission Council.

B. Events Leading to These Proceedings

NOPSI is one of several wholly-owned subsidiaries of Middle South Utilities, Inc. ("MSU") and is engaged in the retail sale of electricity to consumers in New Orleans (other than the 15th Ward, Algiers). Grand Gulf I is a 1250 megawatt nuclear generating plant located in Port Gibson, Mississippi, a 90% ownership interest in which is held by System Energy Resources, Inc. ("SERI") (the corporate name of which formerly was Middle South Energy, Inc. ("MSE")), another wholly-owned subsidiary of MSU. Originally projected to cost $875 million, Grand Gulf I

entered commercial operations in July of 1985 at a cost in excess of $3.6 billion.

NOPSI became involved in the Grand Gulf project in 1974 when, without informing the Council, it entered into the first of a series of agreements with MSE and other MSU-owned operating companies, pursuant to which it joined in providing the basis for the financing of the plant by agreeing to pay part of its costs and purchase a portion of its output. Neither these nor subsequent agreements appear to have been the result of arms-length bargaining and they were not approved by the Council.

The Council first became aware of the potential impact of Grand Gulf on NOPSI and New Orleans' ratepayers after NOPSI had already committed in 1980 to take a 29.8% share of Grand Gulf I. In September 1980, a hearing was held before the Council on NOPSI's application for a capacity adjustment clause that would have allowed NOPSI automatically to pass through its Grand Gulf costs to the ratepayers without additional action by the Council. NOPSI's Chief Executive Officer, James M. Cain, testified then that New Orleans' ratepayers would *not* have to pay for Grand Gulf should the Council deem it inappropriate, and that NOPSI would instead sell its Grand Gulf power to other utilities.

In 1983, Grand Gulf I became the subject of proceedings before the Federal Energy Regulatory Commission ("FERC"), which exercises jurisdiction over the sale of electricity at wholesale in interstate commerce pursuant to the provisions of the Federal Power Act, 16 U.S.C. § 8 *et seq.* In Opinions No. 234 (31 FERC ¶ 61,943) and No. 234A (32 FERC ¶ 61,424), issued on June 13, 1985 and September 26, 1985, respectively, the FERC found that the share of Grand Gulf I accepted by NOPSI's management was unreasonable and excessive. The FERC allocated the capacity and cost responsibility of Grand Gulf I among NOPSI and the other MSU-owned operating com-

panies as follows: Arkansas Power & Light Company ("AP&L")—36%; Louisiana Power & Light Company—14%; Mississippi Power & Light Company ("MP&L")—33%; NOPSI—17%. The FERC's decision was reversed and remanded for reconsideration of these allocations. *Mississippi Industries v. Federal Energy Regulatory Commission*, 822 F.2d 1104 (D.C. Cir. 1987), *cert. denied*, 56 U.S.L.W. 3414 (1987). Recently, the FERC issued a further decision on remand in which the agency reaffirmed its prior allocation. *System Energy Resources, Inc.*, Opinion No. 292, 41 FERC ¶ ___ (Nov. 30, 1987).

While the FERC's decision requires that NOPSI be responsible for 17% of Grand Gulf I costs, the FERC did not address the question of how or in what manner such costs should be recovered through NOPSI's retail electric rates. Nor did the FERC address the prudence of the management of NOPSI or other individual operating companies with respect to Grand Gulf; problems associated with possible "rate shock" threatened by the magnitude of the costs; the need for "phased-in" retail rate approaches; or other matters relating to retail rates. The decision of the FERC is addressed later in more detail.

Following the FERC's decision, NOPSI initiated a retail ratemaking proceeding by filing an application for retail rate relief with the Council on May 17, 1985. NOPSI requested the Council's permission to increase its electric rates for the principal purpose of paying capital-related expenses associated with its share of Grand Gulf I, approximately $168 million per year.

After several hearings and extensive federal court litigation, described *infra*, the Council on March 20, 1986, adopted Resolution No. R-86-112, which accepted, subject to certain modifications, a settlement proposal advanced by NOPSI with respect to its application for permanent rate relief. The settlement required that NOPSI's shareholders absorb approximately $51.2 million of Grand Gulf

I costs and provided that remaining costs would be phased-in as retail electric rates over approximately 12 years, with annual rate increases limited to approximately 6 percent. The settlement assured that the full Grand Gulf I expenses would not be immediately passed through to ratepayers, an event that would have resulted in an immediate retail rate increase of 60 percent or more and would have subjected the New Orleans community to severe "rate shock."[2] Moreover, the settlement expressly provided that it did not curtail the Council's right to conduct this proceeding concerning the prudence of NOPSI's involvement in the Grand Gulf project; to municipalize the electric service by acquisition of NOPSI's assets; or to pursue a lawsuit pending in state court regarding the possible abrogation of NOPSI's Grand Gulf contracts.

C. The Proceedings

The active participants in this prudence investigation have included NOPSI, legal and technical consultants retained by the Council, and one intervenor, Citizens for Safe Energy, Inc. After the close of evidence on the substantive issue of imprudence, the Attorney General of the State of Louisiana sought and was given permission to intervene. His position was limited to the remedy phase of this proceeding and is described later. Members of the public also have been permitted, at various Council meetings, to express their views regarding the issues involved in the general rate proceeding.

The evidentiary portion of this investigation was conducted in two phases. The first phase was devoted to the substantive issues bearing upon the prudence of NOPSI's

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[2] There was testimony in the rate case that immediate implementation of the rate increase proposed by NOPSI would have resulted in the loss over 6,000 jobs, pushed the income of 1,760 families below the poverty line, made it impossible for over 1,100 otherwise qualified families to qualify for mortgage loans, and otherwise would have had a profound adverse impact on the community.

management. The second phase focused on the appropriate remedy to be imposed in the event imprudence were found. During the first phase NOPSI filed prepared testimony, including exhibits, on December 16, 1985. Thereafter, expert consultants retained by the Council submitted prepared testimony on March 19, 1986. NOPSI submitted prepared rebuttal testimony on March 31, 1986. Depositions were taken of 17 persons, including the proposed witnesses and others. Hearings were conducted before a Hearing Examiner appointed by the Council, John B. Farmakides, formerly an official of the federal Nuclear Regulatory Commission, and extended over a period of eight days between April 4 and 14, 1986. This phase of the proceedings resulted in an extensive evidentiary record comprising more than 100 exhibits (including all the depositions taken) and about 2000 pages of hearing transcript.

During the second phase of the proceeding, which focused on the possible remedies and their economic impact if imprudence were found, NOPSI and the City's consultants filed additional prepared testimony in September and October 1986. Further hearings were conducted before the Hearing Examiner in the period October 21 to 24, 1986. Additional testimony regarding the impact of the Tax Reform Act of 1986 was submitted in February 1987, and a final hearing was held on February 24, 1987. The record was thereafter officially closed, and a certified index was submitted to the Council on April 16, 1987. On October 23, 1987 the Council conducted a public hearing on the prudence inquiry, at which the participants were given the opportunity to present their views. Issuance of a decision in this matter was necessarily delayed during the pendency of settlement negotiations and by other intervening utility matters which occupied the Council's attention.

Appendix A hereto is an index of the evidentiary record for the first phase of the proceeding, prepared and submitted by the Hearing Examiner. Appendix B hereto is the Hearing Examiner's index of the evidentiary record

for the second phase of the proceeding. References to pages in the transcript are in the form "Tr. ___." References to exhibits are in the name of the party originating or sponsoring the exhibit, often followed by a page number (e.g., "NOPSI Exh. 36 at 17" or "CNO Exh. 5 at 142").

Attached as Appendix C is a list of the witnesses in this proceeding and others playing a significant role in the events under review, along with a brief biographical treatment of each.

II. SUMMARY OF THE FINDINGS OF THE COUNCIL

On the basis of this record, we have reached the following findings and conclusions as to the actions of NOPSI's management with respect to Grand Gulf:

1. In 1974, NOPSI's management committed to an indeterminate responsibility to pay for Grand Gulf, such that it did not know the amount of power and energy for which NOPSI would be responsible or NOPSI's cost exposure. It did so virtually without placing any limits on NOPSI's liability. The share of Grand Gulf for which NOPSI might be ultimately responsible was subject to factors beyond the control of NOPSI's management. While it may well have been necessary and proper for NOPSI to secure new sources of additional capacity in 1974, the indeterminate and uncontrollable nature of its commitment to one massive project cannot be squared with sound or prudent management. Moreover, the indefinite nature of contractual commitments undertaken at the outset of the project became part of the factual record that permitted the FERC to allot a 17 percent share of Grand Gulf I to NOPSI despite its much smaller relative size among the operating companies.

Because of the FERC's determination, which legally establishes NOPSI's share of Grand Gulf I, we do not, however, alter or interfere with that allocation or base any monetary remedy on the foregoing finding of imprudence.

Although we disagree vigorously with the size of the FERC's allocation to NOPSI and will continue to contest that allocation in federal court proceedings, we are obligated to accept it for this proceeding as binding on the company and as the authoritative establishment of NOPSI's wholesale rate for Grand Gulf I.

2. The manner in which NOPSI's management maintained oversight and review of its Grand Gulf obligation as the project went forward was uncritical and severely deficient, particularly during the important 1979-80 time period, which was characterized by NOPSI's management as a "very dynamic time." There were, with respect to Grand Gulf, no established committees within NOPSI, no regular procedures for handling or analyzing information, no meetings on important events, little if any prior consultation with NOPSI's board of directors, and substantially no effort to probe the significance of currently unfolding events and circumstances of great potential importance. At best, NOPSI's management simply remained ignorant of important information and the significance of events that had a dramatic impact on NOPSI's Grand Gulf commitment. At worst, NOPSI's management was caught up in an effort to portray Grand Gulf as a great benefit to ratepayers at a time when it knew the prospect to be otherwise. Its actions fell far short of prudent management.

3. If NOPSI's management had been aware of important new developments in the forecasting of nuclear plant costs, as it should have been, and if it had properly appraised the impact of the Three Mile Island incident in March 1979, NOPSI's management, acting prudently, would have tried to reduce the risk of NOPSI's Grand Gulf commitment by means that were available to it. Instead, it did the opposite. In January 1980, in the wake of Three Mile Island, it committed to a 29.8 percent share of Grand Gulf I, which was then an unfinished nuclear plant—a share that the FERC found to be excessive—and

made no effort to reduce its risk exposure. NOPSI could be sure that it would be required to take some portion of Grand Gulf as a matter of system responsibility, and should have sought to limit its risk by selling all or part of its share off-system—as it later told the Council it could do. NOPSI could then have purchased less expensive coal-fired capacity to meet its future needs. NOPSI took no such action or other measures, and such inaction was grossly imprudent under circumstances as they existed in 1979-80.

4. We find that in 1979-80, NOPSI should have sold substantially all of its Grand Gulf share off the system, just as its president testified before the Council in September 1980 that NOPSI could do. However, for present purposes, and based on the expert testimony in the record, we are willing to assume that NOPSI might have retained a portion of Grand Gulf I relative to its comparative size within the MSU system—that is, about 9 percent of the system's Grand Gulf I obligation. In other words, NOPSI could have stood by its commitment to take and pay for Grand Gulf I power as required by the System and ultimately determined by the FERC, but should have reduced its risks by making power sales of that portion of its commitment which exceeded a 9 percent share of Grand Gulf. Thus, for the purpose of retail ratemaking, the amount of NOPSI's share of Grand Gulf I above 9 percent should—in the absence of the further considerations discussed below—be passed through as retail rates only at the cost level of coal-fired power, which NOPSI should have obtained as an alternative. On average, this would result in about a 31 percent "effective" reduction in the dollar amount of Grand Gulf I costs that NOPSI could reflect in its retail rates—although, it is important to make clear, this results from an offset to such costs and not from a rejection of the FERC's allocation of them.

5. We have determined, however, that in the circumstances currently facing NOPSI, disallowance of the full

amount warranted by NOPSI's imprudence would cause NOPSI to become insolvent and force its bankruptcy. Further, since NOPSI would be unable to pay all expenses associated with its FERC-determined allocation of Grand Gulf I, such a result might be viewed as an attempt to undercut the FERC's allocation, contrary to our stated intention in conducting this proceeding. Based on the evidence advanced in the second phase of the hearings, we believe NOPSI could withstand an imprudence deduction of $150 million on a one-time basis and, as a matter of caution and conservatism, we have reduced that potential disallowance by a ten percent buffer. We therefore conclude that $135 million of costs attributable to Grand Gulf I should not be recovered in retail rates, this to be implemented as provided herein.

6. As part of our final order in this matter, to assure the feasibility of financing, we shall further specify (a) that there shall be no further deductions for imprudence respecting Grand Gulf I; (b) that NOPSI shall be given timely consideration of rate relief in the future allowing for recovery of its legitimate costs unrelated to Grand Gulf, plus a reasonable rate of return; (c) that NOPSI shall receive prompt consideration of applications for financing necessary to fund its operations; and (d) that the Council understands the need for reasonable assurance to debt and equity investors in NOPSI as to the safety of their investments.

7. We emphasize that our findings and conclusions in this matter are without prejudice to any action that may be taken with respect to both the municipalization of electric service in New Orleans and the "abrogation" lawsuit now pending in Louisiana State courts.[3] Moreover, in the event of a new and different wholesale cost allocation by the FERC or a significant change in financial conditions,

[3] *City of New Orleans v. New Orleans Public Service, Inc.*, No. 84-4767 (Civ. Dist. Ct. for the Parish of Orleans).

the Council shall review the determinations made in light of changed circumstances.

III. PRELIMINARY MATTERS

A. Litigation and Procedural Disputes

Upon acquiring regulatory jurisdiction from the LPSC on May 15, 1985 as previously described, the Council faced the task of establishing the procedural framework within which to execute its regulatory function. However, two days after the Council assumed regulatory authority, and prior to the adoption of filing requirements and procedures, NOPSI filed a retail rate application reflecting its Grand Gulf I costs. The course of proceedings did not run smoothly. After initially proposing a settlement, NOPSI took the position that the Council was required to pass through the full costs of Grand Gulf I immediately, without moderation, and without regard to potential "rate shock" affecting the New Orleans community. It commenced litigation seeking court-ordered rate relief as well as damages from the Council and its members individually. Its litigation efforts were substantially unsuccessful. These events are described below.

After the Council reacquired regulatory authority, it moved promptly to develop filing requirements and other necessary procedures. The Council recognized that NOPSI's application for permanent relief could not be acted upon immediately. Thus, at a public hearing on July 25, 1985, we noted that no formal request for interim rate relief had been filed by NOPSI, and we invited NOPSI to file such a request pending a final rate determination. We offered expedited treatment "in order to prevent any undue hardship" to the company. Council Motion MM-85-326.

NOPSI did not file a request for interim relief but instead, on August 2, 1985, it commenced an action in the United States District Court for the Eastern District of Louisiana seeking declaratory and injunctive relief order-

ing the immediate pass through of Grand Gulf I costs as retail rates—on the ground that the FERC's ruling as to wholesale rates was determinative as to retail rates. NOPSI also sought one billion dollars in damages against the City of New Orleans, the Council, and its members, personally and individually. *New Orleans Public Service, Inc., v. The City of New Orleans*, Civ. Action No. 85-3398 (E.D. La. Sept. 16, 1985) ("*NOPSI I*"). At a hearing on August 12, 1985, the district court, by oral order, denied NOPSI's motion for preliminary injunction. After the denial of NOPSI's motion, and pursuant to district court order, NOPSI sought interim relief from the Council on August 19, 1985. We acted upon NOPSI's request expeditiously. On September 5, 1985 the Council adopted Resolution R-85-526, which granted NOPSI $28.3 million interim relief, specified that NOPSI could recover, for the period of the Council's deliberations, the amount finally determined to be proper and invited NOPSI to seek further interim relief if necessary. Acting upon the advice of expert consultants, the Council determined that NOPSI, given this relief, could remain in a positive cash position through March 1986.

On September 25, 1985, NOPSI requested certain revisions to and clarifications of the grant of interim relief. The Council conducted a public hearing on this request on October 3, 1985. By Resolution R-85-635, issued October 10, 1985, the Council responded to the matters raised in NOPSI's request and again indicated the Council's willingness to review further the need for interim rate relief if merited by future circumstances.

On September 16, 1985, the district court, upon defendants' motion, dismissed NOPSI's complaint on the basis of the Johnson Act, 28 U.S.C. 1342, and the abstention doctrine. In a written opinion, Judge McNamara noted that "the Council is using every feasible alternative to keep NOPSI in a positive cash position." Slip op. at 11. After the dismissal of its lawsuit, NOPSI made a partial submission of its refiled application on September 30,

1985, two weeks overdue, and completed its submission on October 11, 1985. On October 17, 1985, NOPSI filed a notice of appeal of the district court's order in *NOPSI I* to the Court of Appeals for the Fifth Circuit.

On October 10, 1985, the Council, as part of its retail rate proceedings, adopted Resolution R-85-636 (the "Prudence Resolution") which initiated this investigation of NOPSI's prudence with respect to its purchase of power and energy from the Grand Gulf plant and requested NOPSI to respond to a series of questions related to the investigation within 30 days (by November 18, 1985).

NOPSI did not submit such a response, but instead, NOPSI and its affiliate, MSE (SERI), commenced a second action in federal district court on November 14, 1985, seeking a temporary restraining order and injunction against the conduct of the prudence investigation—based on substantially the same grounds as were involved in the prior action. *Middle South Energy, Inc. v. The Council of The City of New Orleans*, Civ. Action No. 85-5273 (E.D. La., Dec. 11, 1985) ("*NOPSI II*"). On December 11, 1985, the district court, on motion, dismissed the second action on essentially the same grounds as it had dismissed *NOPSI I*.

Concurrently with the filing of *NOPSI II*, NOPSI filed its brief in its Fifth Circuit appeal of *NOPSI I* and moved for expedited appeal. NOPSI's affiliate, MSE, filed a motion for leave to file an *amicus curiae* brief in the *NOPSI I* appeal.

Following the dismissal of its second lawsuit and approximately one month out of time, NOPSI submitted prepared testimony and exhibits in this proceeding on December 16, 1985, in response to the inquiries set forth in our Prudence Resolution. A week later, NOPSI filed a motion for a new trial in *NOPSI II*.

On February 14, 1986, the Court of Appeals issued an opinion reversing the district court's determination in

NOPSI I, that it did not have jurisdiction because of the Johnson Act, or should not exercise it because of the abstention doctrine, and the appellate court determined that the case should be remanded for a determination on the merits—as to which it expressed no opinion except to reject certain contentions made by NOPSI.[4] *New Orleans Public Service, Inc. v. The City of New Orleans*, 782 F.2d 1236, 1242 (5th Cir. 1986). The Court of Appeals, however, did not issue a mandate with respect to its decision, and therefore jurisdiction in *NOPSI I* was not returned to the district court. On June 10, 1986, the Clerk of the Court of Appeals issued a letter to the parties indicating that the Court was considering withdrawal of that portion of its opinion dealing with the abstention doctrine and affirmance of the district court's decision, and it requested additional briefs from the parties. These were submitted on June 25, 1986.

On September 2, 1986, the Court of Appeals issued a new opinion, 798 F.2d 858 (5th Cir. 1986), in which it withdrew Part IV of the previous opinion dealing with abstention and affirmed the district court's dismissal of the case on abstention grounds. The Court noted in part that, "the regulation and adjustment of local utility rates is of paramount concern and a matter which demands local administrative expertise." (*Id.* at 862.) The Supreme Court denied NOPSI's petition for a writ of certiorari, notwithstanding the submission of a brief by the FERC and the Solicitor General as *amici curiae* in favor of review. 107 S.Ct. 1910 (April 20, 1987).

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[4] Despite the express requests of NOPSI to decide, as a matter of law, that the Council's regulatory activities were preempted, the Fifth Circuit Court of Appeals specifically declined to do so. The Court noted that (1) NOPSI's claim of preemption was based upon inferential grounds (slip op. at 9); and (2) the cases upon which NOPSI principally relied did not support an immediate pass through of Grand Gulf costs to retail ratepayers. 782 F.2d at 1242.

After the initial decision of the Court of Appeals, NOPSI filed, on February 25, 1986, a motion for summary judgment in *NOPSI II*. This was denied on March 13, 1986. On March 17, 1986, NOPSI filed motions in *NOPSI II* seeking partial summary judgment and/or clarification, expedited review, and certification of certain questions to the Court of Appeals. Through these motions, NOPSI sought to have the district court bar the Council's discovery into a number of areas. (As discussed in the next section, NOPSI had refused to provide certain discovery sought by the Council.) Supplemental briefs were filed on April 1, 1986, at which time the district court took the motions under advisement. However, in a telephone conference between Judge McNamara and the parties shortly before the commencement of the prudence hearings, the Court rejected the rulings requested by NOPSI and indicated that its prior rulings were not to be used by NOPSI as a basis for its refusal to provide discovery to the Council. (Tr. 1897.) On October 28, 1986, after the Council filed a new motion to dismiss based on the final decision in *NOPSI I*, NOPSI filed a First Supplemental and Amended Complaint. NOPSI no longer sought to bar the Council from conducting a prudence inquiry. Rather, it sought an injunction which would bar the Council "from entering an order . . . as a result of the 'prudence' investigation . . . which would have the effect of 'trapping costs', that is, compelling NOPSI or its shareholders to absorb all or part of the costs allocated to NOPSI" by the FERC. This was an apparent attempt to shield NOPSI in advance from any monetary penalty even if imprudence were found and regardless of the facts developed. On December 19, 1986, the district court dismissed the Amended Complaint on the basis of (1) the abstention doctrine; (2) lack of ripeness; and (3) as to SERI, its lack of standing. That decision was affirmed on the ground of lack of ripeness by the Fifth Circuit on December 11, 1987, 833 F.2d 583 (5th Cir.

1987), and a petition for rehearing was denied in January 1988.

B. Efforts to Block Discovery

Throughout the course of the proceedings, NOPSI repeatedly declined to provide information and to comply with the Council's discovery requests promptly and fully.

At the outset of the prudence inquiry, NOPSI put a great premium on speed. Its complaint in *NOPSI II* alleged that the Council's conduct of a prudence inquiry might have the effect of delaying a decision on its rate application. Nevertheless, NOPSI consistently responded late and incompletely to requests for data and document production.

More important is that when NOPSI did respond, it categorically refused to produce relevant materials. As support for its refusal, NOPSI relied primarily upon language from the district court's decision in *NOPSI II*, having nothing to do with discovery.[5] NOPSI failed, for example, to produce:

- documents relating to any attempt or effort by NOPSI to negotiate arrangements for Grand Gulf other than it had agreed upon (Cain Deposition Request 8, Hurstell Deposition Request 11, McLetchie Deposition Request 11);
- documents constituting or referring to actions that NOPSI might take or has taken with respect to any financial difficulty in connection

[5] In its decision, the district court stated its view as to what the Council proposed to do in its prudence inquiry and what it proposed not to do. *NOPSI II*, Slip op. at 7-8. NOPSI asserted that this statement barred discovery of numerous matters which it claimed were outside the court's recital. In a telephone conference shortly before commencement of the hearings, the court expressly informed the parties, without addressing the overbreadth of NOPSI's assertions, that its decision was not to be taken to be a bar to discovery at all. (*See* Tr. 1897.)

with the construction or operation of Grand Gulf or NOPSI's obligations with respect to Grand Gulf (Cain Deposition Request 9, Hurstell Deposition Request 12, McLetchie Deposition Request 12);

- documents relating to any nuclear unit other than Grand Gulf I, in response to a request for all documents relating to the actual or potential effect upon ratepayers of Grand Gulf or any nuclear plant in the Middle South System constructed on or after January 1, 1974 (Cain Deposition Request 1, Hurstell Deposition Request 4);
- documents relating to any attempt, effort or suggestion within or by NOPSI or any other MSU operating company (a) to curtail the construction of Grand Gulf 1 or 2; or, (b) to accelerate it (Cain Deposition Request 2, Hurstell Deposition Request 6, McLetchie Deposition Request 5).[6]

In addition, NOPSI either refused to produce or provide answers for many of the data requests submitted by the Council's staff and consultants, or provided incomplete responses.[7] Certain documents requested during depositions,

[6] Similarly, NOPSI erroneously relied upon *American Electric Power Service Corporation*, 32 FERC ¶ 61,363 (1985)—a FERC decision having nothing to do with discovery—as a basis for objecting to other, obviously pertinent, discovery requests. *See* Cain Deposition Request 3; McLetchie Deposition Request 6 (requesting all documents related to any analyses by NOPSI on the possibility of obtaining capacity or energy from sources other than Grand Gulf in lieu of capacity or energy from Grand Gulf or any other nuclear plant).

[7] *See e.g.*, Data Request PB-1 (requesting a copy of every major study or analysis, conducted by or for NOPSI, from January 1, 1970 through the present, pertaining to the economics of construction, continued construction, and/or operation of Grand Gulf I); Data Request PB-8

and which were otherwise called for (for example, the periodic cost forecasts for Grand Gulf) were never produced at all.

NOPSI categorically refused to allow inquiry into the activities of any other company in the Middle South system, regardless of their relevance to the actions of NOPSI's own management. Nevertheless, throughout these proceedings, NOPSI has relied on a "system" defense. It has argued that the predicament in which it has found itself with respect to Grand Gulf was the result of "system" decisions for which NOPSI cannot be held accountable. When it was in its interest to do so, NOPSI proffered witnesses from other companies to testify as to actions of the "system" and to particular events involving other companies. Moreover, it submitted documents prepared by other MSU companies as well as those found in the files of a sister company.

For example, NOPSI submitted testimony of Regis Trumps, an employee of Middle South Services, Inc., and it proffered the testimony of George White, an employee of MSU, concerning the response by Middle South companies to the Three Mile Island incident.[8] NOPSI also introduced documents from sister companies, such as an

(requesting estimates of the cost to construct Grand Gulf made from the construction of the project through the present); Data Request PB-13 (requesting all estimates prepared by, or on behalf of NOPSI, after 1975, concerning the costs associated with terminating Grand Gulf).

[8] On April 14, 1986, the final day of the evidentiary hearing concerning the prudence phase of this proceeding, NOPSI sought to call George White, Jr., as a witness. No written testimony of Mr. White had previously been submitted and the offer of his testimony was contrary to the rules of practice and procedure adopted by this Council for presentation of evidence. Nonetheless, this Council agreed to accept Mr. White's testimony into the record if NOPSI agreed to comply with several conditions generally aimed at ensuring discovery of matters relevant to Mr. White's testimony. *See* Council Ltr. April 19, 1986. NOPSI refused to comply with such conditions. *See* NOPSI letters dated April 28, 1986 and May 2, 1986.

LP&L Memorandum re: Allocation of Future Generation Under System Agreement (*see* Response to Data Request PC-5), system documents such as MSU generation planning studies, (*see* Exhibits MLH-8A, MLH-8B, MLH-14), and documents it found in the files of LP&L purporting to bear on the relative economics of coal and nuclear power after the Three Mile Island incident. (Tr. 781.)

Despite its own reliance on "system" testimony and its selective use of materials from other companies, NOPSI blocked the Council's discovery of matters involving the activities of other companies in the system bearing upon matters involving NOPSI's own management.[9]

On this basis, NOPSI's counsel blocked many inquiries into meetings involving Mr. Cain and the officers of other Middle South companies, held as part of the activities of MSE. NOPSI's counsel often instructed witnesses not to answer questions concerning, *e.g.*, discussions of the MSE Board of Directors (CNO Exh. 28 at 17); communications with other operating companies, relating, for example, to the ability of ratepayers to bear the cost of Grand Gulf (*Id.* at 48); and the existence of studies relating to the possibility of cancelling or curtailing the Grand Gulf 1 or 2 projects. (*Id.* at 86.)

Similarly, NOPSI, objecting that the Council's requests inquired into management decisions of NOPSI's parent or sister corporations, refused to respond to such requests as those for:

> documents referring to need or desire of NOPSI for construction or operation of Grand Gulf or

[9] For example, during the deposition of James Cain, counsel for NOPSI stated:

> Further, I will not permit Mr. Cain to respond to any questions as to any activities, or any conduct of his in any capacity other than as president of NOPSI . . . .

(CNO Exh. 28 at 5.)

> such need or desire on the part of any of NOPSI's affiliated operating companies, or the lack of such need in each case.

(*Id.*, Document Request 10, McLetchie Deposition Request 13.)

Only just before the commencement of the actual hearings, when Judge McNamara instructed the parties that discovery was not to be limited as NOPSI contended, did NOPSI produce additional documents, but its production remained deficient. Moreover, by adopting categorically the position that it would not produce documents relating to other Middle South companies, throughout substantially all the discovery period, NOPSI successfully frustrated the efforts of the Council's expert consultants to obtain information. (Tr. 1690-1692.)

The position taken by NOPSI through the discovery phase of the prudence inquiry was wholly at odds with the common understanding of the scope of discovery held by courts and practitioners in virtually all jurisdictions. The scope of discovery is very broad. Inquiries need only be reasonably calculated to lead to evidence that may be used at a trial or hearing.

The fact that a particular substantive decision would not be a part of the Council's considerations—for example, whether NOPSI's ultimate share of Grand Gulf as determined by the FERC was proper—does not preclude or obviate inquiry into the process by which NOPSI and its sister companies went about deciding upon their original allocations. For one thing, it is indispensible background for an understanding of what happened here. For another, it could produce important insight into the views of NOPSI and its sister companies as to whether Grand Gulf was perceived as a benefit or a burden at critical points in time, when other actions might have been taken.

Similarly, questions about whether consideration was given to cancelling Grand Gulf would shed light upon

whether and when the operating companies may have appreciated the growing detriments of Grand Gulf. They would also test the representations made by NOPSI, publicly and before the Council, that Grand Gulf would be a great benefit to New Orleans' ratepayers. These and similar lines of inquiry were blocked by NOPSI's refusal to provide relevant information.

Most disturbing to the Council is the implausible paucity of documents produced by NOPSI relating to Grand Gulf. Despite the fact that this was a project of unprecedented magnitude for which NOPSI had assumed a major commitment, there are few intercompany and nearly no intracompany memoranda produced by NOPSI relating to Grand Gulf. For example, none of the notes or agendas relating to the meetings of the MSE board or of the Middle South Operating Committee ("MSOC"), or among NOPSI personnel, seem to have survived; if they did they were not produced. As another example, the Three Mile Island incident portended a major impact on nuclear plant costs; but there were no memoranda dealing with the effect, or lack thereof, on the Grand Gulf project, authored by NOPSI personnel or by others in the "system," in NOPSI's files. As another example, the process by which NOPSI ultimately decided to take, or was given, a 29.8 percent share of Grand Gulf I must have been of great importance and concern; yet no NOPSI memoranda were produced relating to it either. Given the usual and expectable practices of business management, there are serious and unsettling questions generated by the dearth of production of such documents.

C. Due Process Issues

NOPSI has asserted that this proceeding is "fraught with arbitrary and capricious actions by the Council expressly calculated to deny NOPSI its right to a fair and complete hearing." (NOPSI Br. at 16.) In view of NOPSI's attempt to disrupt the ratemaking proceedings, to prevent

a prudence inquiry, and to block discovery of its managements' actions, its charges of procedural detriment would seem to be diametrically misdirected.

NOPSI's assertions rest principally upon two matters. First, NOPSI argues that the Council failed to allow NOPSI sufficient time within which to prepare its rebuttal case in phase one of the proceedings. Second, it claims that the Council's unwillingness to accept the testimony, offered by NOPSI out-of-time, of a proposed surrebuttal witness—unless NOPSI's first provided discovery relating to the subject matter of his testimony—violated its rights to due process.

By way of background, the Council has, from the outset, been committed to a prompt resolution of NOPSI's retail rate application, as indicated by the expeditious treatment given to its application for interim relief and other matters. During the main part of the rate case NOPSI stressed its interest in a speedy resolution, particularly prior to the settlement that allowed certain increased rates to go into effect. Judge McNamara had also expressed strong interest at that time in the Council's acting promptly.

After settlement of the retail rate proceeding and the grant of rate relief, NOPSI's interest in a speedy resolution of the prudence investigation became less than clear. At times, NOPSI appeared as willing to have the prudence proceeding deferred. At other times it appeared desirous of concluding it promptly. The Council acted on an expedited schedule to accommodate NOPSI's professed interest in a speedy resolution. All participants in these proceedings were forced to comply with tight time schedules. While NOPSI claims that it had too brief a time within which to prepare its rebuttal testimony, the attorneys for the Council had an even shorter period of time in which to obtain discovery as to this testimony, which included that of two entirely new expert witnesses, as well as new testimony from three other witnesses.

However, the twelve day period for preparation of rebuttal testimony, which NOPSI deems too short, clearly appears to have resulted, at the worst, in inconvenience and certainly not in actual detriment. NOPSI filed detailed and extensive rebuttal testimony, now part of the record. Until NOPSI proffered the testimony of George White at the close of the hearings, there was no occasion on which NOPSI claimed that it had not been able to prepare testimony, and it never pointed to any specific matter as to which it was deprived of an opportunity to develop evidence.

We should add that a right to procedural due process does not include a right to file prepared written rebuttal testimony. Due process requires that a party whose rights are to be adjudicated be given a meaningful opportunity to be heard in a meaningful way. *See Goss v. Lopez*, 419 U.S. 565, 581 (1975). NOPSI was clearly given an opportunity to present its position as part of its direct and rebuttal cases, to present and rebut evidence, to depose and cross-examine witnesses testifying on behalf of the Council, and to participate in a full and fair hearing.

NOPSI also claims that it experienced "difficulty in obtaining a fair hearing" in connection with its attempt to call two surrebuttal witnesses on the last day of the hearing. One was Regis Trumps, who had submitted two volumes of direct and rebuttal prepared testimony, as well as oral testimony at the hearing. The matters as to which he was to testify as a surrebuttal witness were cumulative. (*See* Tr. 1881-82, 1889.) NOPSI's offer of Mr. Trumps was properly rejected by the Hearing Examiner. (Tr. 1886.)

The other proposed witness was George White, Jr., an employee of Middle South Utilities, Inc. He was offered to testify on surrebuttal as to certain matters concerning the response of MSU and the "system" to the Three Mile Island incident, certain information said to have been given to the board of directors of MSE and related matters.

Subsequently, the Council received from NOPSI's attorneys, pursuant to their letter dated April 16, 1986, a volume entitled "Proffered Testimony of George White, Jr."[10] No written testimony of Mr. White had previously been submitted by NOPSI, and the offer of his testimony was well out of time and otherwise contrary to the rules and procedures adopted for the conduct of the hearings, as was conceded by NOPSI's counsel. (Tr. 1901.) While NOPSI claimed that Mr. White's testimony would address matters first raised by the Council's witnesses during the hearing, this was not so. The matter involved—the utility's response to the Three Mile Island incident—had been put in issue since at least December, 1985 during the deposition of Mr. Cain (*see, e.g.*, CNO Exh. 28 at 71-76) and in January 1986 during the deposition of Mr. Hurstell (*see, e.g.*, CNO Exh. 29 at 665-686).

Instead, NOPSI's offer of Mr. White's testimony brought into sharp focus NOPSI's strategy, highly prejudicial to the Council, of refusing to allow discovery as to important matters involving other Middle South companies, while, at the same time, offering such material and related witnesses when to do so suited NOPSI's purposes. (*See* Tr. 1981-1900.) Although the Council would have been justified in refusing NOPSI's offer outright, instead, by a letter dated April 22, 1986, we granted NOPSI's request to provide an additional hearing date to hear the testimony of Mr. White, on the condition that it provide documentary discovery, to be followed by discovery by oral examination, of matters pertinent to the subject matter of such testimony.[11]

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[10] If Mr. White's formal testimony had been in substance as set forth in the document mentioned in text, it would have denigrated the impact of the Three Mile Island incident on the basis of selective treatment of certain technical issues.

[11] The Council also made it a condition that the Council's attorneys have the right to present rebuttal testimony if desired, and that NOPSI make available witnesses to authenticate two documents emanating from companies in the Middle South system.

NOPSI rejected that proposal and, by letter dated April 28, 1986, insisted that the prepared text of Mr. White's proffered testimony be accepted "as evidence," without any discovery relating to its subject matter, or apparently any cross-examination. Moreover, NOPSI claimed that the reason that Mr. White's testimony had not earlier been offered was that "it had too little time in which to prepare its rebuttal testimony." The record shows that there is no substance in this assertion. NOPSI's offer of Mr. White came about because the Hearing Examiner had properly rejected NOPSI's offer of certain self-serving material in the 1979 Annual Report of MSU (NOPSI Exh. 42) as substantive evidence of the "system's" response to the Three Mile Island incident—an area as to which NOPSI had refused to provide discovery. Thereafter, on the last hearing day, April 14, NOPSI's counsel first offered Mr. White as a witness, giving as the reason the desire to satisfy the evidentiary objections to said NOPSI Exhibit 42. At no prior time did NOPSI suggest to the Council or the hearing officer that it wanted to call Mr. White as a witness, but had inadequate time in which to prepare his testimony. The Council, by letter dated April 30, 1986, responded to NOPSI's refusal to provide discovery and its demand that the written testimony of Mr. White be accepted "as evidence," stating in part,

> "We categorically reject the idea that NOPSI may enjoy the special privilege of offering witnesses and preparing subject matters for introduction into evidence without giving an opportunity to test their truth and significance through discovery and examination."

Such determination is hereby reaffirmed, and the "due process" objections of NOPSI are rejected as without substance.[12]

IV. LEGAL STANDARDS IN THESE PROCEEDINGS

A. The Purpose of and the Standards Governing This Prudence Investigation

Our inquiry into the prudence of NOPSI's conduct at the retail level with respect to Grand Gulf is based upon the longstanding principle that costs may be passed onto ratepayers only to the extent that they have been prudently incurred. *See Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276 (1923). The contemporary role of the prudence doctrine has been described as follows:[13]

> The concept of a prudent investment in public utility law is a regulatory oversight standard that attempts to serve as a legal basis for judging whether utilities meet their public interest obligations. . . .
>
> • • •
>
> . . . .State commissioners today are pulled between the obligation to keep utilities financially sound and able to provide reliable service to customers and the obligation to set rates at a level reasonably related to the costs of providing service. They have been forced to choose between these two obligations where large investment values are at stake and where commission action exposes either stockholders or ratepayers to severe financial losses. The concept of prudence provides commissions with a principle that does not necessarily require an "all or nothing" decision in favor of one side, but can allow some sharing of the risks between investors and ratepayers. The prudent investment test is a tool that regulators are using to provide an answer to the question of who should bear which risks and associated costs.

[12] Copies of the foregoing correspondence shall be considered part of the record of this proceeding.

[13] Burns, Poling, Whitman and Kelly, *The Prudent Investment Test in the 1980s*. The National Regulatory Research Institute, 1985, pp. iv, vi.

In the last several years, the construction of nuclear generating plants has given occasion for the conduct of prudence investigations, which have, in notable cases, resulted in substantial cost disallowances. For example:

- The New York Public Service Commission, after investigating the prudence of LILCO's management and construction of the Shoreham Nuclear Plant, disallowed $1.395 billion of the $4.5 billion costs of Shoreham.[14]
- The Missouri Public Service Commission, after investigating Union Electric's prudence with respect to the 84% share of the Callaway plant within its jurisdiction, disallowed $384 million of the $2.5 billion in Callaway costs for which Union Electric had sought recovery.[15]
- The Missouri Public Service Commission, finding, *inter alia*, that a significant portion of the cost

[14] Case 27563 (*Long Island Lighting Company - Phase II - Proceeding on Motion of the Commission to Investigate the Cost of Construction of the Shoreham Nuclear Generating Facility*) Opinion No. 85-23 (issued Dec. 16, 1985) ("*Shoreham*").

[15] *In the Matter of the Determination of In-Service Criteria for the Union Electric Company's Callaway Nuclear Plant and Callaway Rate Case and Related Issues*, Case No. EO-85-17 (MoPSC March 1985) ("*Callaway*").

overruns at the Wolf Creek nuclear plant resulted from unreasonable or unexplained cost increases and inefficient or imprudent management of the project, disallowed approximately $126 million (14%) of Kansas City Power & Light Company's portion of the plant under Missouri jurisdiction.[16]

- The Michigan Public Service Commission, based primarily on the imprudent delay in the plant's completion, disallowed $122.9 million of the $1.925 billion Detroit Edison spent on its Belle River coal plant.[17]

- The Maine Public Utilities Commission, after investigating the prudence of the investments of Maine utilities in the Seabrook nuclear power project, entered into a rate case settlement with Central Maine Power Co. whereby Central Maine Power Co. agreed that 40%, or $14.8 million, of its Seabrook-2 construction costs would not be recovered, as well as 30%, or $63.9 million of the Seabrook-1 construction expenses incurred before January 1, 1985.[18]

- The Public Utilities Commission of Ohio recently disallowed for ratemaking purposes $627.8 million

[16] *In the Matter of Kansas City Power & Light Company of Kansas City, Missouri, for Authority to File Tariffs Increasing Rates for Electrical Service Provided to Customers in the Missouri Service Area of the Company, and the Determination of In-Service Criteria for Kansas City Power & Light's Wolf Creek Generating Station and Wolf Creek Rate Base and Related issues*, Case No. EO-85-185 (MoPSC, April 23, 1986).

[17] *In the Matter of the Application of Detroit Edison Company for Authority to Amend Its Rate Schedules Governing the Supply of Electric Energy and Amend Other Miscellaneous Rates*, Case No. U-7660 (MoPSC, July 16, 1985).

[18] *Central Maine Power Co.*, Case 84-120, Order and Stipulation, (MePUC May 30, 1985).

of the cost of building the $5.5 billion Perry nuclear power plant owned by Centerior Energy Corp., Ohio Edison Co., and Duquense Light Co. as imprudently or unreasonably incurred.[19]

A prudence review is an appropriate function of the ratemaking authority and has been undertaken where, as here, the utility's actions have resulted in extraordinary costs that raise the clear prospect of actual harm to the ratepaying community and are clearly out of line with competing sources of generation.

1. Standard of Prudence

The standard of prudence to be applied in reviewing the evidence is not in serious dispute. Experts testifying on both sides of this case have agreed that the standard should be that of "reasonableness under the circumstances."[20] NOPSI stated the standard of prudence to be:

> whether the utility followed a course of conduct that a capably managed utility would have followed in light of existing and reasonably knowable circumstances.

In re Seabrook Involvements by Maine Util., 67 P.U.R. 4th 161, 166 (Maine 1985) ("*Seabrook*"). NOPSI Memo Re Item VII at 3-4. Augmenting this formulation, we believe the standard should be:

> The Company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the Company had to solve its problems prospectively rather than in reliance on hindsight. In effect, our respon-

[19] *Wall Street Journal*, Jan. 13, 1988, p. 36.

[20] (*See* NOPSI Br. at 19; CNO Exh. 31 at 5;) Memorandum Submitted By NOPSI in Response to Item VII of City Council Resolution R-85-636, at 3-4 (December 16, 1985) ("NOPSI Memo Re Item VII"); (NOPSI Exh. 46 at 3) (December 13, 1985).

> sibility is to determine how reasonable, competent management would have performed given the circumstances that confronted the company.

In substance, this standard has been applied in prudence investigations by the New York Public Service Commission,[21] the Missouri Public Service Commission,[22] the Washington Utilities and Transportation Committee,[23] and the Massachusetts Department of Public Utilities.[24] In addition, the Federal Energy Regulatory Commission ("FERC") has adopted the same standard of prudence.[25]

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[21] *Shoreham*, Slip op. at 9.

[22] *Callaway*, Slip op. at 12.

[23] *See Washington Utilities and Transportation Committee v. Puget Sound Power & Light*, 62 P.U.R. 4th 557, 584 (WUTC 1984) (the following test was applied to measure prudence: what would a reasonable board of directors and company management have decided given what they knew or reasonably should have known to be true at the time they made a decision.)

[24] *See also Fitchburg Gas & Electric Light Company*, D.P.U. 84-145-A (Mass. 1985) and *Boston Edison Company*, D.P.U. 906 (Mass. 1981) (prudence is defined as the utility management's having made a reasonable decision based on what it knew or should have known at the time of the decision.)

[25] *See New England Power Company*, 31 FERC ¶ 61,047 at 61,084 (1985) where the FERC stated:

> In performing our duty to determine the prudence of specific costs, the appropriate test to be used is whether they are costs which a reasonable utility management (or that of another jurisdictional entity) would have made, in good faith, under the same circumstances, and at the relevant point in time. We note that while in hindsight it may be clear that a management decision was wrong, our task is to review the prudence of the utility's actions and the costs resulting therefrom based on the particular circumstances existing either at the time the challenged costs were actually incurred, or the time the utility became committed to incur those expenses.

NOPSI has asserted[26] that the following "well accepted guidelines" must be followed in applying the reasonableness standard of prudence:

1. there should exist a rebuttable presumption that the questioned decision of the utility is prudent;
2. a utility decision should be judged under the circumstances that were known or should reasonably have been known when the decision was made;
3. hindsight should not be used in determining prudence; and,
4. prudence should be determined in a retrospective, factual inquiry—looking to the circumstances when the decision was made.

We believe that these guidelines are embodied in the standard of prudence we have adopted, and we therefore have followed such guidelines in reaching our decision. (We discuss below the circumstances under which the presumption of prudence may be rebutted.) In addition, in general accord with other local regulators,[27] we have also considered the following factors in our determination of NOPSI's prudence:

- Senior utility executives are expected to possess a high degree of management expertise, and where their position so requires, financial and technical expertise as well.
- While the prevailing practice of the utility industry is relevant, it is not determinative, since the practice may be the result of self-interest

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[26] *See* NOPSI Memo Re Item VII (at p. 3-4).

[27] Both the New York Public Service Commission in *Shoreham* and the Maine Public Utilities Commission in *Seabrook* considered these factors in their respective prudence inquiries. *See Shoreham* Slip op. at 12, 14; *Seabrook* at 166-167.

and may not be prudent in respect to the obligations that the utility is bound to fulfill. Industry norms may be an indication of whether the company's responses to its problems were reasonable at the time. The decisions of utility executives must also be reasonable when viewed against the decisions and conduct of other corporations that make investment decisions of a comparable size and complexity and other relevant facts.

- The size and nature of the project being reviewed must be considered. Thus, greater care should be exercised where the magnitude of the investment is in the hundreds of millions or billions of dollars than when lesser businesses or responsibilities are involved.
- Prudent management requires an ongoing review of project expenditures, an obligation to seek out relevant information and continuing action in response to changing circumstances.
- Management has an obligation to comply with legal requirements, including its obligation as a utility to provide reliable electric service at economic rates.

Finally, we note NOPSI's statement that then Councilman Barthelemy articulated the "correct standard to be applied in this matter" when he stated, in an affidavit, that the Council has an obligation to ensure that NOPSI's rate payers are not forced to bear costs "incurred imprudently by the utility as a result of mismanagement or gross neglect . . . ." Affidavit of S. J. Barthelemy, *Middle South Energy, Inc. v. The Council of the City of New Orleans*, at 3, Civil Action No. 85-5273 (E.D. La. Dec. 5, 1985). We view the term "mismanagement" as synonymous with the failure to act reasonably under the circumstances, for example, by a marked failure to meet one or more of the

relevant factors noted above. While costs resulting from "gross neglect" by utility management certainly should not be passed on to ratepayers, a finding of imprudence is not, of course, dependent upon a finding of gross neglect. Ratepayers are entitled by law to a higher standard of performance by utility management than the mere avoidance of gross neglect.

2. Burden of Proof

In a normal rate case, the utility must prove that its rates are just, reasonable and nondiscriminatory. There is some dispute as to whether a utility bears the burden of proving, in its case-in-chief, that all decisions and expenditures were prudent.[28] Here, we will follow the FERC's position that there is a rebuttable presumption that the company's decisions and expenditures were prudent.[29] Thus, when NOPSI filed its request for Grand Gulf related rate relief, there existed a presumption that NOPSI's Grand Gulf related decisions and expenditures were prudent.

This presumption of prudence may, however, be rebutted and the burden of proof returned to the proponent of

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[28] A presumption of prudence has been generally upheld by the FERC and apparently is derived from Justice Brandeis' concurrence in *State of Missouri ex rel. Southwestern Bell Telephone Co.*, 262 U.S. 276, 289 (1923) wherein he stated:

> Every investment may be assumed to have been made in the exercise of reasonable judgment unless the contrary is shown.

However, in *Shoreham* the New York Public Service Commission, noting that the Public Service Law imposes on the utility the burden of proof in a rate proceeding, stated that the company bears that burden in a prudence inquiry as well, where the regulatory body is attempting to identify the costs that may properly be included in rates. *Shoreham* at 6.

[29] *See New England Power Co.*, 31 FERC ¶ 61,047, 61,081-61,082 (1985); *Commonwealth Edison Company*, 27 FERC ¶ 63,072, 65,269 (1984).

the rate increase. According to the FERC, "where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent." *Minnesota Power & Light Company*, 11 FERC ¶ 61,312, 61,645 (1980). "A 'doubt' is created if the challenge raises a question, the answer to which, is not unarguably in favor of prudence. Moreover, a doubt is 'serious' if there appears at least a possibility that, upon due investigation, the answer to the question will lead to a finding against prudence." *New England Power Company*, 27 FERC ¶ 63,037, 65,157 (Nacy A.L.J. 1984) *rev'd on other grounds*, 31 FERC ¶ 61,047 (1985).

Even before the introduction of testimony by attorneys for the Council, the facts and circumstances surrounding NOPSI's involvement in Grand Gulf, apparent at the time the Council initiated this prudence investigation by adopting Resolution No. R-85-636, created serious doubt as to whether NOPSI's conduct was prudent. Specifically, Resolution No. R-85-636 noted, *inter alia*, that:

- NOPSI entered into a series of open-ended agreements whereby it guaranteed the indebtedness of MSE for construction of Grand Gulf and assumed responsibility for Grand Gulf capacity and power, without restrictions on the ultimate cost of the plant and without limits on NOPSI's cost responsibility;
- At a time when the cost of Grand Gulf already had greatly exceeded prior cost estimates, NOPSI agreed to a very large share—subsequently determined to have been excessive by the FERC—and to relieve AP&L of its share;
- NOPSI failed to diversify its fuel sources and relied heavily upon a single nuclear power project to satisfy its projected energy needs; and

- Despite escalating Grand Gulf cost overruns and despite NOPSI's assurance to the Council that the Company could sell Grand Gulf power to other entities, NOPSI made no apparent attempt to reduce its risks.

In addition, the enormity of the cost overruns experienced in the construction of Grand Gulf and the potentially disastrous impact these posed for the ratepaying public raised a serious issue regarding the prudence of NOPSI's planning and management conduct. In October 1975, Grand Gulf I was projected to cost $875 million and to be completed by January 1980. The plant actually entered commercial operation in July 1985 at a cost of $3.3 billion for MSE's 90 percent share. The Missouri Public Service Commission, in its investigation of the prudence of the Callaway Nuclear Plant, stated that "the existence of $2 billion in cost overruns raises doubts as to prudence in this case."[30]

However, the foregoing circumstances do not stand alone. There was direct expert testimony in this case that NOPSI had acted imprudently. The testimony of NOPSI's own witnesses established that NOPSI failed to develop any internal organization to deal with its responsibility to maintain oversight of its Grand Gulf obligations, failed even to hold meetings on important issues, failed to examine critically information being received as to costs, failed to obtain necessary information, failed to keep abreast of available analytical techniques, failed to explore alternatives, did not even know what its rights were within the Middle South System, and ultimately accepted, and did nothing to reduce the risks of, a large fixed share of an unfinished nuclear plant that the FERC, prior to the commencement of this proceeding, found to be approximately *70 percent higher* than the share that would have been

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[30] *Callaway*, Slip op. at 12.

fair. These circumstances create, by any standard, grave doubts as to whether NOPSI's management engaged in prudent conduct, and such management certainly should bear the burden of proving that it did so.

On most issues, however, allocation of the burden of proof does not play a determinative role. Both sides came forward with evidence on the matters in issue. The findings made herein principally reflect both undisputed facts and the clear weight of the evidence, and rarely rely upon NOPSI's bearing the burden of proof.

B. Federal Preemption

The remaining legal issue to be addressed is that of federal preemption. Throughout this prudence investigation, NOPSI has challenged, on the grounds of federal preemption, the Council's authority to conduct a prudence investigation into NOPSI's involvement in Grand Gulf. The central thesis of NOPSI's argument is that the FERC, in Opinion Nos. 234 and 234-A, allocated the costs and power of Grand Gulf I, thereby determining such Grand Gulf costs to be just and reasonable. Hence, it argues, inquiry into NOPSI's prudence, with the potential for the disallowance of a portion of the costs of Grand Gulf, would "frustrate" or "stand as an obstacle" to the Federal Power Act and Opinion Nos. 234 and 234-A. In addition, NOPSI has argued that our investigation impermissibly interferes with interstate commerce.

We note at the outset that neither the purpose nor the effect of this prudence investigation is to interfere with interstate commerce. NOPSI had argued that the effect of any rate disallowance in this proceeding would be to shift costs to other states in violation of the commerce clause of the U.S. Constitution.

Without expressing our view as to whether a shifting of costs, even for legitimate reasons, would be constitutionally permissible, it is clear here that there is no im-

permissible burden on interstate commerce. Prior to the conclusion of the rate case here, every other operating company on the Middle South System had entered into a settlement with its respective regulatory authority that involved rate "phase-ins" (that is, the costs of Grand Gulf I would not be fully passed through as incurred, but at later dates) and, in the case of the two largest operating companies, permanent "absorptions" (that is, a portion of the costs would never be passed through to ratepayers).[31]

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[31] The settlement between AP&L and the Arkansas Public Service Commission requires AP&L to forego recovery of approximately 20 percent of its Grand Gulf costs and states:

> The proportionate reductions in revenues from AP&L's Arkansas retail customers under this paragraph will be permanent and will never be recovered from AP&L's Arkansas retail customers (except to the limited extent provided elsewhere in the settlement).

AP&L also agreed to defer recovery of large portions of its remaining Grand Gulf costs (41 percent in the first year) for collection after the year 1995. *Arkansas Power and Light Company*, Docket No. 84-249-U, Order No. 26 (APSC, Sept. 9, 1985).

The Mississippi Public Service Commission on September 16, 1985 issued an order deferring recovery of approximately one-third of MP&L's share of Grand Gulf I from its retail customers for the ten-year period 1985-1995. Remaining amounts were ordered to be phased-in over a three year period starting in 1985. *Mississippi Power and Light Co.*, Docket No. U-4620, (MPSC, Sept. 16, 1985) (Slip op. at 3). The MPSC order was issued subsequent to the completion of an investigation into the costs of, and MP&L's "performance" in relation to, Grand Gulf. Decision Management Company, Inc., *Grand Gulf Construction Audit*, April, 1985. (CNO Exh. 29, MLH - 19A & B).

On October 15 and 16, 1985, the LPSC held hearings on the adequacy of a report it had commissioned in 1983 concerning, *inter alia*, the prudence of LP&L in regard to Grand Gulf. Decision Management Company, Inc., *A Report on Waterford 3/Grand Gulf Study*, January, 1984. The LPSC announced its intention to conduct an expanded prudence review. However, on November 19, 1985, LP&L and the LPSC reached a settlement whereby LP&L agreed to absorb 18 percent of

It was not suggested by NOPSI that the result of these phase-ins and absorptions would be to "shift" burdens to the ratepayers of New Orleans. Moreover, the testimony of NOPSI's own president here established that rate absorption in one jurisdiction did not shift costs to those in other jurisdictions or otherwise have impermissible adverse interstate effects. (CNO Exh. 28 at 125-131.)

Turning to the requirement that the Council recognize the FERC's establishment of a wholesale rate, it should be noted at the outset that in our Prudence Resolution, we expressly stated that "[t]he Council will not seek to invalidate any of the agreements surrounding Grand Gulf I or to order NOPSI to pay MSE a rate other than that approved by the FERC." *See* Resolution R-85-636 at 4. Our purpose is, instead, to review the prudence of the management of NOPSI—a utility operating under a franchise granted by this City—as to the actions it took and could have taken, so as to ensure that only prudently incurred costs are passed on to New Orleans' consumers in their local electric rates.

The issue before the FERC was that of establishing a "method of allocation"—that is a "formula" for the sharing of the power generation costs of Grand Gulf I among the four Middle South operating companies. Ultimately, all the Middle South operating companies, as well as other parties, became involved in an interstate dispute as to what formula should be used to determine individual company responsibility for Grand Gulf I costs as wholesale power rates.[32] In Opinion Nos. 234 and 234-A, the FERC chose a formula that allocated the investment costs of all nuclear, but not other, facilities according to each com-

its Grand Gulf I costs. *Louisiana Public Service Co.*, Order No. U-16945 (LPSC, Nov. 14, 1985).

[32] *See Middle South Energy, Inc.*, 26 FERC ¶ 63,044 at 65,097, 65,104 (1984) (Initial Decision); 31 FERC ¶ 61,305 at 61,634, 61,635 (Opinion No. 234).

pany's demand. 31 FERC ¶ 61,305 at 61,655. Wholesale rates—representing the formula-generated share of the aggregate of Grand Gulf costs—were set for each of the operating companies. (The FERC's substantive allocation, as previously indicated, was reversed and remanded by the Court of Appeals for the District of Columbia Circuit, and thereafter was reaffirmed by the FERC.)

The FERC did not purport to assert jurisdiction over the retail rates to be charged by the operating companies to their local customers, did not presume to preempt the function of the state retail regulatory bodies, did not deal with the problem of "rate shock", did not address the timing or manner in which, or extent to which, the operating companies may recover Grand Gulf-related costs from their customers, did not examine the alternatives available to a company to reduce the risks of its Grand Gulf cost responsibility, and did not examine the prudence of NOPSI's activities, or those of any other operating company, with respect to Grand Gulf.

At the Grand Gulf cost allocation hearings at the FERC, Presiding Judge refused to be drawn into making indirect or implied rulings on prudence:

> MR. MERRIMAN:
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> • • •
>
> Now, Middle South Energy is exclusively subject to the jurisdiction of the FERC. It is a 100 percent wholesaler. We don't want somebody later someplace to say that therefore the costs involved in that construction were somehow unjust and unreasonable because you did something wrong.
>
> PRESIDING JUDGE: Okay.
>
> But I can't preclude parties here from somewhere else raising anything they want to raise. And the only thing that I'm concerned about is what mat-

> ters I should decide. And the only thing that I'm concerned about is what matters I should decide. And as far as I can see I don't have to decide the issue of the prudence of the construction—of the decision to construct the Grand Gulf project.

Middle South Energy, Inc., Docket No. ER82-616-000, Transcript of Proceedings, March 14, 1983, at 235-36.

The Presiding Judge was clear that the prudence of the individual MSU companies as *purchasers* of Grand Gulf power should not be a part of his determination:

> MR. O'SULLIVAN: I just wanted to make sure that there was no confusion between the prudence inquiries that I understand you ruled this morning *the states were entitled to make.*
>
> That is, *the prudence of the affiliates* under the jurisdiction of the states making a purchase of Grand Gulf power for purposes of retail resale, and that that issue is not stipulated, the buyers is not stipulated to.
>
> PRESIDING JUDGE: *I'm not getting into that* I don't think in this case.
>
> MR. MERRIMAN: He's not saying one way or the other what the jurisdiction of the state commissions are.
>
> PRESIDING JUDGE: *I'm not getting into that.*

Id. at 228 (Emphasis added.)

At the close of the relevant dialogue, the Presiding Judge said to Mr. Merriman:

> PRESIDING JUDGE: *I don't think you can put me in a position or this Commission in a position of deciding a prudency issue on the allocation issue in such a way that no one can possibly raise*

> *this in the State Court.* I think that's the problem you have. I may be wrong.
>
> I don't intend to get into state jurisdiction, but I do intend to get into what a fair and just and reasonable and non-discriminatory rate schedule and agreement is.
>
> MR. EASTLAND: *Wholesale* level.
>
> PRESIDING JUDGE: At the *wholesale* level.

Id. at 248. (Emphasis added.)

In its Opinion Nos. 234 and 234-A, the FERC acknowledged the traditional role of the states in retail ratemaking regulation:

> [W]e concurred in [Judge Head's] discussion of the need to balance Federal and states interests in exercising our jurisdiction. Furthermore, we think our opinion, taken as a whole, as well as Judge Head's discussion, which we adopted, clearly recognize the role of the states in regulating the retail electric rates and the need to balance overlapping state and Federal electric rate jurisdiction.

Middle South Energy, Inc., 31 FERC ¶ 61,305 (1985) at p. 61,951. The FERC concluded:

> The basic nature of regulatory control retained by the states under previous System agreements remains unchanged. What our decision attempts to do is amend the filed agreements to achieve a non-discriminatory sharing of excess capacity cost imbalances on the integrated System, consisted with the goal of the System Agreement, and to do so with as little intrusion on the States as possible.

Id. at p. 61,952.

In March 1986, the FERC's acting Chairman Sousa, testifying before Congress on behalf of the FERC, stated as follows:

> The Commission did not determine the prudence of the purchase of power by the Middle South Utilities from the Grand Gulf Nuclear Generating Station in Opinion Nos. 234 and 234-A.
>
> At issue in Opinion Nos. 234 and 234-A were the narrower questions of whether the proposed Middle South System Agreement and Grand Gulf Unit Power Sales Agreement allocated the costs of generation and transmission on the Middle South system among its members in a manner that was just, reasonable, not unduly discriminatory or preferential. The proceeding was not one in which the operating utilities attempted to pass through the actual costs associated with the Grand Gulf plant as purchased power expenses in rates charged to their customers.[33]

In contrast to the FERC proceedings, this prudence investigation addresses questions that arise at the retail ratemaking level, and particularly whether NOPSI's management acted prudently with respect to its Grand Gulf participation and the alternatives available to NOPSI's management in this regard. Were we to adopt a different allocation formula as the basis for retail rates than that adopted by the FERC for wholesale rates, such an action would certainly be in derogation of the FERC's authority and violate the Supremacy Clause of the Constitution. *Nantahala Power & Light Co. v. Thornburg*, 106 S. Ct. 2349 (1986). But we do not do so. The inquiry here

[33] Prepared Testimony of the FERC Before Subcommittee on Energy, Conservation and Power, of the House of Representatives Committee on Energy and Commerce, Hearings on Prudence Review (March 1986) Question 11.

falls within the area reserved by *Nantahala*—*i.e.*, whether there were alternatives by which NOPSI could have curtailed its costs and risks with respect to Grand Gulf. Moreover, there was no independent issue of the prudence of management in the *Nantahala* case as, in contrast, there is here.

The investigation of management's prudence in connection with the setting of retail rates is, as recognized by Congress in the Federal Power Act, by the FERC and by the courts, within the jurisdiction of local regulatory entities.[34] The FERC has noted that local regulators retain jurisdiction to review the prudence, from the standpoint of the purchasing utility, of wholesale transactions approved by FERC. In *Southern Company Services, Inc.*, 26 FERC ¶ 61,360 (1984), the FERC stated:

> [T]he question of the prudence of a utility's power purchases is properly an issue in the buying utility's rate case where it seeks to pass the cost of its purchased power on to its ratepayers.

26 FERC at 61,795. *See also Pennsylvania Power & Light Co.*,, 23 FERC ¶ 61,005 (1983); *Philadelphia Electric Co.*, 15 FERC ¶ 61,264 (1981).

Similarly, judicial review of NOPSI's challenges has reaffirmed our authority to conduct this prudence investigation. In dismissing, on jurisdictional grounds, NOPSI's challenge to this Council's prudence investigation in *NOPSI II*, Judge McNamara stated:

> The issue which is involved here pertains to whether or not NOPSI, one of the utility com-

[34] *See Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985); *Cambridge Electric Light Co.*, Docket No. 84-2B-2 (Mass. D.P.U. May 10, 1984), *appeal docketed*, No. 84-161 (Sup. Ct. Mass., filed May 24, 1984) (Stipulation of Dismissal, Nov. 21, 1985). *Pike County Light & Power Co. v. Pennsylvania Public Utility Commission*, 77 Pa. Commw. 268, 465 A.2d 735 (1983).

> panies that is required to purchase certain power from Grand Gulf as prescribed by the FERC, may be ultimately required to absorb a portion of that cost *if* a prudence investigation by the regulatory authority reflects that the management of NOPSI, *not* the management of the parent or sister corporations, acted imprudently in taking or failing to take certain actions. It is important to note that the FERC opinions are devoid of any proscriptions against local regulatory authority undertaking prudence inquiries. . . . In sum, after reviewing the FERC's opinions and the Council's Resolution, this court has concluded that the Council's prudence investigation does not breach any duty imposed by the FERC's opinions nor does it violate any of their provisions.[35]

Similarly, in addressing NOPSI's contention that the Council's prudence investigation impermissibly interfered with interstate commerce, the court observed:

> No matter what the Council ultimately decides after investigating NOPSI's prudence, the fact remains that NOPSI will still be required to pay its 17 percent allocation as mandated by the FERC. The only question will be whether the cost of that allocation will come entirely from the ratepayer or whether it will be borne in part by the ownership of NOPSI. Consequently, the Council's prudence inquiry has no, and implicates no, interference with interstate commerce.[36]

On the appeal of *NOPSI I*, the Court of Appeals, despite express requests of NOPSI to do so, specifically declined

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[35] *Middle South Energy, Inc. v. The Council of the City of New Orleans*, Civ. Action No. 85-5273 (E.D. La. Dec. 11, 1985), ("*NOPSI II*"), slip op. at 7.

[36] *NOPSI II* at 8.

to hold that the Council's regulatory activities were preempted. Rather, the court noted that the cases upon which NOPSI principally relied did not support any immediate pass through of costs to retail ratepayers:

> However, we do not decide, as NOPSI contends we must, whether NOPSI will prevail in its preemption claim. Achieving federal jurisdiction does not guarantee success on the merits of a claim. *See Montana-Dakota*, 341 U.S. at 249. We therefore do not determine whether the Council must immediately pass through NOPSI's costs. Indeed, the *Narragansett* case, on which NOPSI so heavily relies, did not itself require immediate pass through of costs to retail ratepayers. . . .[37]

The Fifth Circuit also refused to adopt any of the FERC's contentions, submitted as *amicus curiae* in *NOPSI I* (but not stated in Opinions 234 or 234-A) that it had preempted state ratemaking functions as a matter of law.

In *NOPSI II*, the Fifth Circuit again made clear that the *Nantahala* case left retail-level considerations open for state action. 833 F.2d at 586.

In light of the facts developed during this investigation, which form the basis for our decision here, we think that our authority to act has not been, and could not properly be, preempted by the FERC, given the dual regulatory authority established by Congress in the Federal Power Act. *See* 798 F.2d 860.

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[37] *NOPSI I*, 782 F.2d at 1242.

PART B. DETAILED PRUDENCE ANALYSIS

V. STATEMENT OF FACTS

A. The Middle South System

1. Overview[28]

NOPSI is a wholly-owned subsidiary of MSU and provides electric service within the municipal boundaries of the City of New Orleans pursuant to its franchise with the City. NOPSI is a member of the "Middle South System," which includes, *inter alia*, four electric operating company subsidiaries of MSU—NOPSI, AP&L, LP&L and MP&L—as well as MSE (now SERI), MSU's wholly-owned generation company and owner of a 90% interest in the Grand Gulf plant; Middle South Services, Inc. ("MSS"), a service company; and other direct and indirect subsidiaries of MSU. (NOPSI Exh. 35, pp. 2-3.) Service is provided by LP&L to a large part of Louisiana and to the 15th Ward of New Orleans (Algiers); by MP&L to a large part of Mississippi; and by AP&L to parts of Arkansas and southeastern Missouri.

The Middle South System operates as an electric power pool, in which the high voltage transmission facilities of the individual operating companies are interconnected. (NOPSI Exh. 39 at 4.) The power pool is an integrated electric system and serves a 92,000 square mile area covering the four states mentioned above. (*Id.*, p. 3.)

With the recent exception of Grand Gulf, all generation facilities on the system have been built, owned and operated by individual operating companies. (NOPSI Exh. 35 at 5; NOPSI Exh. 39 at 3.) Many of these plants have been certified by the Council or state regulatory commissions and, for retail ratemaking purposes, each is considered as within the rate base of the operating company

[28] Certain names and terms have been previously defined or abbreviated at pages 3-5 *supra*.

that owns it. All of the generating units, including Grand Gulf, are centrally-dispatched and controlled by the Middle South Operations Center in Pine Bluff, Arkansas. (CNO Exh. 39 at 3.)

2. SEC Approval of the Middle South Reorganization Plan

In 1949, the Securities and Exchange Commission ("SEC") approved the plan of reorganization, submitted under Section 11 of the Public Utility Holding Company Act ("PUHCA"), 15 U.S.C. § 79k (1981), pursuant to which MSU was created and was to own the common stock of NOPSI, AP&L, LP&L and MP&L. *Electric Power & Light Co.*, 29 SEC 52, 67 (1949). The SEC found (29 SEC at 62, 67) that the plan would comply with the directives of section 11(b)(2) of PUHCA, which requires the SEC to ensure that the existence of a holding company "does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding company system." 15 U.S.C. § 79k(b)(2).

In 1953, the SEC found that the Middle South system constituted an "integrated public-utility system" within the meaning of sections 2(a)(29) and 11(b)(1) of the PUHCA. 15 U.S.C. §§ 79b(a)(29), 79k(b)(1). *In Re Matter of Middle South Utilities, Inc.*, 35 SEC 1 (1953). Section 2(a)(20) defines an integrated public-utility system as one that is "physically interconnected . . . and which . . . may be economically operated as a single interconnected and coordinated system . . . in one or more states, not so large as to impair . . . the advantages of localized management, efficient operation, and effectiveness of regulation . . . ." 15 U.S.C. § 79b(a)(29).

Section 11(b)(1) of PUHCA directed the SEC

> (1)To require by order . . . that each registered holding company, and each subsidiary company

> thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system . . . .

15 U.S.C. § 79k(a)(1).

In connection with its finding of integration, the SEC reviewed, *inter alia*, the system's interconnected transmission grid, its use of a central dispatch center, interaffiliate sales, and off-system sales. 35 SEC at 7-10. As to generation planning on the system, the SEC found:

> The record indicates that the construction programs of the Middle South system are coordinated through an operating committee. This committee meets regularly and reviews and estimates the system loads for a period several years in advance. Estimates are also made of the required system generating capabilities and of the individual companies. On the basis of these estimates, the operating committee makes its recommendations to the individual companies' managements as to the installation of additional generating facilities and construction of transmission lines. The record indicates that this system planning has made possible the installation of larger generating units than would be feasible if each of the companies were operated as individual entities, and has also resulted in lower unit costs for the power produced as well as lower initial installation costs.

(*Id.* at 8.) The SEC concluded:

> Based upon the record developed in the Electric proceedings and supplemented by the instant proceedings, we conclude that the electric system of Middle South constitutes an integrated public utility system. In reaching this conclusion, we have considered the long historical record of unified operations of the electric facilities, the extent of regulation by State Commissions, and the fact that the system is not so large as to impair the effectiveness of regulation in any of the states in which the company operates. We have also considered the high degree of coordination which, in part, appears to be due to common control, leading in turn to common planning development.

(*Id.*)

In regard to retention of non-electric properties, the SEC noted that AP&L and MP&L had disposed of their gas operations prior to the proceeding (*id.* at 2) and ordered LP&L to divest its gas operations. (*Id.* at 14.) However, the SEC permitted NOPSI to retain its gas and transportation operations on the basis of governmental policies exercised by the City of New Orleans:

> New Orleans' operations of the electric, gas and transportation services are conducted pursuant to indeterminate permits granted by ordinances of the Commission Council of the City of New Orleans, supplementary to an ordinance adopted in 1922 commonly known as the "Settlement Ordinance." That Ordinance provides, among other things, for the establishment and continuing determination of the Company's rate base, the rate of return on the rate base, and the rates and fares to produce such return. It also provides that the City have a perpetual option to purchase parts or all of the property, at the rate base values.

. . .

The Commission Council of the City of New Orleans exercises complete regulatory jurisdiction over the Company with respect to rates, accounting, property acquisitions, and issuance of securities.

The record contains an affidavit of the Commissioner of Public Utilities of the City of New Orleans which sets forth a statement of policy of the City concurred in by the Mayor of New Orleans and all the members of the Commission Council of the City. That statement of policy sets forth that the unified operation of electric, gas and transportation operations by New Orleans is the result of careful planning on the part of the City and is designed "to foster and safeguard the benefits which this City acquired for itself in connection with the 1922 reorganization." That statement of policy also sets forth that the City "has certain well defined legal rights to have the operations continue as they have" and that "for both legal and practical reasons therefor, the City will firmly enforce its rights and protect the benefits which it enjoys under the present local franchise situation."[39] [40]

(*Id.* at 14-15.) The SEC concluded that "[i]n view of the expressed policy of the City with respect to its strong desire for continued unified operations, and in view of the New Orleans franchise situation" it would decline to order divestiture of NOPSI's non-electric facilities. (*Id.* at 15.)

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[39] The SEC itself has no ratemaking authority over NOPSI's sale of electricity. *See* SEC Release No. 23579, *In the Matter of Middle South Utilities, Inc.*, p. 421 (January 23, 1985).

[40] Certain names and terms, previously defined or abbreviated in the text, are set forth in full here as an aid to clarity.

3. History of System Agreements

For several decades, NOPSI and its affiliated operating companies have been parties to a series of agreements governing their power pooling arrangements. These agreements controlled the sales of power and energy between the companies, and were for the most part filed with and approved by the Federal Power Commission ("FPC"), the predecessor of FERC. (NOPSI Exh. 39 at 6.) Recent agreements have continued to reflect both the role and responsibilities of the individual companies on the system and the nature of the joint generation planning in which they engage. (NOPSI Exh. 39 at 6-15.)

When the decision to build Grand Gulf was made, the operative pooling agreement was the "1973 System Agreement." (NOPSI Exh. 35, MLH-15, Item 1.) NOPSI's witness Mr. Regis Trumps, a vice-president of MSS, testified as to the history preceding the 1973 System Agreement as described in the several quoted paragraphs below:

> Prior to 1951, power and energy transactions between the Middle South operating companies were accomplished through various FPC approved service schedules, which were documents setting forth the terms and conditions under which transactions were to occur. In 1951, AP&L, LP&L and MP&L adopted an agreement titled, "Memorandum Re Administration of Intra-System Transactions and System Planning and Development" ("Memorandum Re").

(NOPSI Exh. 39 at 6.) In 1971, Arkansas-Missouri Power Company ("Ark-Mo"), since consolidated into AP&L, also became a party to Memorandum Re. (*Id.*)

Mr. Trumps explained that the benefits sought to be achieved by the Memorandum Re included the following:

> the combined loads of the companies could be provided with less generating capacity; emer-

> gency conditions could be met with a lesser likelihood of severe symptoms; and more efficient generating equipment could be added and installed more economically.

(*Id.*)

NOPSI was not a party to Memorandum Re, but entered into a "similar agreement" with LP&L in 1956. (*Id.* at 6.) (Neither Memorandum Re nor the NOPSI-LP&L agreement is part of the record in this proceeding.)

The 1973 System Agreement was a system-wide pooling agreement that succeeded Memorandum Re. Mr. Trumps testified to its origin as follows:

> Memorandum Re was a reasonably sound agreement, but by the late 1960's it became apparent that a more formal pooling agreement, with up-to-date coordination concepts and pricing parameters, was necessary. An Ad Hoc Committee of one engineering and one rate representative from each operating company and a representative from MSS was appointed to draft what became the 1973 System Agreement. That System Agreement was tendered for filing and was accepted as a just, reasonable, and non-discriminatory rate schedule by the FPC.

(*Id.* at 7.)

As stated in Section 3.01 of the 1973 System Agreement, the purpose of that agreement was:

> to provide the contractual basis for the continued planning, construction, and operation of the electric generation, transmission and other facilities of the Companies in such a manner as to achieve the maximum possible economies consistent with the highest practicable reliability of service, with the reasonable utilization of natural resources and

> effect on the environment, and to provide a basis for equalizing among the Companies any imbalance of costs associated with the construction, ownership and operation of such facilities as are used for the mutual benefit of all the Companies.

(NOPSI Exh. 36, MLH-15, Item 1, p. 11.) The Agreement had three principal functions: (1) it set forth the responsibilities of the operating companies with respect to generation capability, generation planning and power and energy transactions (*see* Article IV); (2) it provided service schedules to govern the power and energy transactions between the operating companies (*see* MSS-1 through MSS-5); and (3) it designated a Middle South Operating Committee ("MSOC") composed of a representative from each operating company and MSU and delineated its role in system planning (*see* Article V).

The anticipated benefits of the 1973 System Agreement, delineated in its Section 3.05, were similar to those of Memorandum Re:

> It is believed, based on experience, that by jointly planning on a system basis for the construction and operation of these major facilities:
>
> (a) The combined loads of the Companies can be supplied with less aggregate installed capacity; and
>
> (b) Installations of additional capacity can be made at lower cost because of the large unit sizes; and
>
> (c) The new installations will be more economical and require less operating labor and maintenance per KW because of the large unit sizes; and
>
> (d) The strengthened transmission system will make possible a fuller utilization of the ca-

pability of the lower cost generating units of the System; and

(e) Emergency conditions in any part of the System or other systems in adjacent areas can be met with less probability of impairment of service to the general public.

(NOPSI Exh. 36, MLH-15, Item 1, p. 12, § 3.05.) Section 3.06 goes on to provide that, as a consequence of these anticipated benefits, it was intended that ". . . each Company shall be willing and able to provide its portion of the major facilities determined to be necessary and that each company shall share in the benefits and pay its share of the costs of coordinated operations . . . ." (*Id.* at 13.)

It is important to note that Section 4.01 of the agreement specifies, "Each Company shall normally own, or have available to it under firm contract, such generating capability and other facilities as are necessary to supply all of the requirements of its customers." (*Id.* at 14.) According to Mr. Trumps:

> This principle recognizes the responsibility of each operating company to finance and construct or arrange for generation sufficient to meet its own load, just as it would have the responsibility to do in the absence of its participation in the power pool. Neither the affiliation of the MSU operating companies through their common parent, MSU, nor the existence of the [Middle South Operating Committee], which is assigned the task of coordinating System-wide planning, relieves any of the MSU operating companies from its public utility duty to serve its franchise load.

(NOPSI Exh. 39 at 16.)

In 1981, a revised system agreement was drafted by representatives of the operating companies. NOPSI and the other companies executed this agreement, known as

the "1982 System Agreement," and filed it with the FERC in the spring of 1982. (NOPSI Exh. 39 at 8.) One of the objectives of the 1982 System Agreement was "to ensure that each MSU operating company has an appropriate share of coal and nuclear base generating units." (NOPSI Exh. 39 at 8.) Details of the 1982 System Agreement are discussed *infra*.

4. Generation Planning On The System

Mr. Trumps provided detailed testimony as to the nature of "the planning process utilized by the operating companies" at the time when the companies decided to build Grand Gulf I, as follows:

1. Each MSU operating company furnished the MSOC as frequently as required, but at least once a year, estimates of its peak load and energy requirements. The MSOC then consolidated these MSU operating company peak and energy forecasts into one Middle South System peak and energy forecast.

2. The MSOC also obtained from each of the operating companies its individual projections of future power supply capability and, after coordinating them, consolidated them, just as the load forecasts had previously been consolidated. A consolidated load and capability forecast was then produced for the overall power supply requirements of the System.

3. This coordination activity performed by the MSOC mainly addressed the installation schedule of generating units, the approximate size and general location of generating units, and considerations of purchases from other utilities.

4. The final decision as to the exact location of a power supply source, its fuel, and exact size

was made by the individual operating company which had agreed to install the generating unit. The location and fuel could not usually be specifically determined until after land, environmental, and transmission studies had been made. Performing these necessary studies was the responsibility of the individual operating companies.

5. The consolidated plans were submitted to and approved by the chief executive officers of the companies. In addition, the Board of Directors of the operating companies approved the construction projects of their respective companies and the expenditures therefor. The individual operating companies then proceeded to secure and obtain such regulatory approvals as may have been required at the time and to finance, construct, operate, and maintain the particular generating units which had been scheduled for installation by them.

(NOPSI Exh. 39 at 16-18.)

The role of NOPSI in the process described by Mr. Trumps prior to 1973 is somewhat unclear in light of the fact that NOPSI was not a party to Memorandum Re. However, at least since the execution of the 1973 System Agreement, it appears that NOPSI and the other operating companies provided the MSOC with their load and capability forecasts, that the MSOC "coordinated" such forecasts and determined the need for new generating units, that such plans were approved by the chief executive officers of the operating companies, and that each individual company determined the specifics of the generating unit undertaken by it and ultimately approved its construction and budgets.

Mr. Cain testified similarly as to generation planning on the Middle South System in a proceeding before the LPSC

in 1983. (CNO Exh. 30(c).) He stated that each operating company was required to plan for its own generation additions and prepared, among other things, load forecasts and customer density studies. Its forecasts were then coordinated with those of the other operating companies by the MSOC. The MSOC then issued an "interim assignment" of a generating unit which was presented to the individual operating company board for final approval. (*Id.*) In Mr. Cain's words:

> An interim assignment of that generation is made to a particular operating company and then it is the decision of that operating company's board of directors to finalize that decision and proceed with the implementation of that decision.

(*Id.*) The operating company independently selected "the size, type and location of the generation units." (*Id.* at 29.)

Mr. Cain stated that "the ultimate, final decision rests with the operating company." (*Id.* at 27.) Further, an operating company could reject a decision of the MSOC (*id.*), just as NOPSI decided against the Alligator Point plant on the basis of site studies (discussed in greater detail below), and as LP&L had rejected the assignment of the St. Rosalie plant. (*Id.*)

5. Cost Allocation Under The 1973 System Agreement

The 1973 System Agreement contained two principal mechanisms for the allocation of the cost of certain electric production among the operating companies. Service Schedule MSS-1 to the agreement, entitled "Capability Equalization," purported to "equalize" generating capability (capacity) among the companies "so that the capability of each company after equalization [would] be equal to its Capability Responsibility." (NOPSI Exh. 35, MLH-15, Item 1, p. 1-1.) Service Schedule MSS-3, entitled "Exchange of Electric Energy Among the Companies," set forth a pric-

ing formula for energy bought and sold on the system by the operating companies. (*Id.* at 3-1.)[41]

The term "equalization" is somewhat a misnomer in the context of the agreement. Capability "equalization" under MSS-1 spread the generating capacity on the system among the four operating companies in proportion to the relative size of their loads. By sharing the costs of *certain* generation plants termed "Participation Units" (which were defined as newly built generation units, some of the capacity of which was in excess of the needs of the operating company that owned it), each company became responsible for a *number of MWs* of system capacity in proportion to its own load. However, because each company was solely responsible for the costs of its own generating plants (in addition to a possible share of Participation Units), and because the costs of such plants were not identical, the capacity *costs* paid by one company could and did vary significantly from that of another company, and were *not* "equalized."

The formula contained in MSS-1 turned on the defined term "Capability Responsibility."[42] A company's Capability Responsibility was determined by first calculating its "Responsibility Ratio"—a measure of the peak load of the company, relative to others' loads. It was calculated by establishing a ratio of the average of each company's four highest non-coincident peak demands[43] to the total peak

[41] Three other service schedules were attached to the 1973 System Agreement: (1) MSS-2, "Transmission Equalization"; (2) MSS-4, "Distribution of Revenue From Sales Made For The Joint Account Of All The Companies"; and (3) MSS-5, "Distribution Of Operating Expenses Of Systems Operations Center."

[42] "Capability Responsibility" was defined in Section 2.13 of the 1973 System Agreement as "the System Capability multiplied by the Responsibility Ratio for that Company." (*Id.* at 8.)

[43] Section 2.10 of the 1973 System Agreement provided:

> *Company Load Responsibility* shall be as follows:
>
> (a) The average of the four highest clock-hour demands in megawatts of a company's system, each on a different day, occurring during the twelve-month period ending with the current month, but not less than 90% of the average of the four highest such demands occurring during the twenty-four (24) month period ending with the current month, where each such demand shall represent the simultaneous hourly input from all sources into the system of a company less the sum of the simultaneous hourly outputs to the systems of other interconnected utilities. (Company demands shall include firm power supplied to other systems for its own account.)
>
> (b) Less the power supplied to others as sales for the joint account of all the Companies.
>
> (c) Less the contractual amount of firm purchases with reserves available during the month from other systems for its own account.

Section 2.11 provided:

> *System Load Responsibility* shall be the arithmetical sum in megawatts of the individual Company Load Responsibilities.

[44] Section 2.08 provided:

> *Capability* shall be the net output in megawatts that can be produced by a generating unit under the conditions specified by the Operating Committee, or the input in megawatts

demand of the system. (NOPSI Exh. 39 at 11.) For example, NOPSI's peak demands have been roughly 9% of the system total, and, accordingly, its responsibility ratio has been approximately 0.09. (*See, e.g.*, CNO Exh. 30(c) at 96.)

The next step was to determine System Capability, defined as the sum of MWs that could be produced by the four companies' generating units or that were under contract. (*See id.*, p. 7, §§ 2.08, 2.09.)[44] A company's Capability

Responsibility could then be derived by multiplying the System Capability by its Responsibility Ratio. If a company had (by ownership or contract) *less* generation capability than its Capability Responsibility, it would be considered "*short*"; if it had *more*, it would be considered "*long*."

Under Section 10.03 of MSS-1, the excess capability (over its Capability Responsibility) of each "long" company would be "allocated to each deficient Company in the ratio of such Company's deficiency to the sum of the deficiencies of the deficient Companies." (*Id.*) The cost of the allocated capability, as determined by Section 10.05 of MSS-1, was based on the monthly fixed costs of the company's "Participation Unit." As previously indicated, "Participation Unit" was defined as the "most recently installed" unit or units owned by a company. (*Id.* at 1-3, § 10.04.)

Thus, to effect capability "equalization," short companies were required to make payments to long companies based on (1) the number of MWs by which they were short and (2) the capital cost of MWs associated with the long companies' participation units.[45] (*See* NOPSI Exh. 39 at 11.) In return for its payments, the short company received an entitlement to the energy generated at the Participation Unit in proportion to the capability allocated to the short company from such plant. MSS-1, § 10.04(b), pp. 1-3 to 1-4.[46]

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available under contract from a supplying source.

Section 2.09 provided:

> *System Capability* shall be the arithmetical sum in megawatts of the individual Company Capabilities.

[45] Under the Schedule MSS-1, a company could be considered short and required to make equalization payments to long companies, even when it had adequate generation of its own and no need for the long company's capacity. Such a situation could arise when, as today, excess capacity exists on the system and each company is obligated to pay for a portion of the excess as part of its Capability Responsibility.

[46] During most of the 1970's, NOPSI was a long company and received payments from the short companies calculated on the basis of the costs of its Michoud 3 plant.

The dispatch of generating plants and the pricing of energy bought and sold between the companies were governed by Service Schedule MSS-3. Section 30.02 of MSS-3 provided that the System Operator would "dispatch" (that is, utilize) the plants in the system to obtain the lowest cost energy for all the companies, *i.e.*, the lowest variable cost units would be dispatched first. Section 30.03 provided that, for billing purposes, the dispatched energy would be allocated on an hourly basis, first to the Company owning the unit (unless such energy was excess from a long company's Participation Unit) and second "to supply the requirements of the other Companies (pool energy)." (*See* CNO Exh. 29 at 237.) Excess energy from a long company's Participation Unit was considered the entitlement of the short companies, in proportion to their capability allocation from such unit, and was known as "entitlement energy." (*Id.*) The pricing of energy exchanged between the companies was determined by Section 30.06 of MSS-3. (*Id.* at 3-3.) Entitlement energy from Participation Units was priced at the cost of fuel to generate such energy. (*Id.*, Section 30.06(a).) Pool energy was priced at the cost of fuel plus an adder. (*Id.*, Section 30.06(b), (c).)

6. Impact of Generation Decisions on Relative Company Costs

The foregoing provision for joint system planning and the allocation of capability have not produced a common cost of service among the operating companies. Capacity costs have been shared only when the plant involved was a Participation Unit of a long company, only to the extent the company was actually long, and only by companies that were short. (NOPSI Exh. 30, MLH-15, Item 1, pp. 1-1 to 1-5.)

Rather, the decisions made by each operating company as to particular generating plants it built or contracted for had great impact on its costs of service (CNO Exh. 29 at 233), and there has been a wide disparity in those costs among the companies. NOPSI's Senior Vice President, Mr. Hurstell, specifically confirmed that an individual operating company's decision as to choice of generation sources affects its costs of electricity. (CNO Exh. 29 at 232.)

Moreover, under the 1973 System Agreement, each operating company was responsible for making "the necessary financial arrangements" to proceed with construction of generation units assigned by the MSOC. (NOPSI Exh. 36, MLH-15, Item 1, p. 15.) Mr. Cain testified that a company was "responsible for the costs associated" with a plant "for which [it had] responsibility." (CNO Exh. 30(c) at 102.) Also, costs other than those of generation contributed to a company's total cost of electricity.

Disparities among the operating companies' costs have been substantial. Over the period 1965 to 1982, NOPSI's average costs of service were the *highest* on the system, exceeding those of AP&L, for example, by over 50%. (CNO Exh. 30(c) at 126.) The costs of electricity to the four companies during that period were:

Operating Company	Cost of Service (per kWh)
NOPSI	6.2
MP&L	6.045
AP&L	4.878
LP&L	3.96

(*Id.*) (Based on the Grand Gulf allocation agreed to by NOPSI in 1980, this disparity was projected in 1983 to *increase* for the period 1983-1992.)[47]

[47] NOPSI, again the highest cost company, would have a total average cost of 16.35 /kWh compared to only 6.73 /kWh for AP&L. CNO Exh. 30(c), p. 127. NOPSI's witness here, Mr. Louiselle, testified before the LPSC in 1983 that Middle South and NOPSI have operated so that NOPSI's ratepayers had incurred the highest electricity costs since at least 1965 (CNO Exh. 33, p. 858).

Thus, NOPSI's status as a member of the MSU "system" did *not* obviate the need for its management to exercise *critical judgment* and act *prudently* in meeting NOPSI's duty to provide economical electric service to the ratepayers of New Orleans in accordance with its public utility and specific franchise obligations. In testifying before the LPSC in 1983, NOPSI's witness here, Mr. Bruce Louiselle (then a consultant to the LPSC), testified as to how NOPSI had fared in meeting its obligations to its ratepayers as follows:

> Q. Mr. Louiselle, I wonder if we can focus for a moment on all that Middle South and NOPSI have done lately for NOPSI's ratepayers. First, Middle South has assigned an excessive allocation of Grand Gulf power to NOPSI, is that correct?
>
> A. Yes.
>
> Q. And NOPSI has acquiesced, is that true?
>
> A. Yes.
>
> * * *
>
> Q. Now, the second thing that Middle South and NOPSI have done to NOPSI's ratepayers is to allow AP&L out of its obligation to take an allocation of Grand Gulf, is that correct?
>
> A. Yes.
>
> Q. And NOPSI's ratepayers will incur greater costs as a consequence of that action, is that true sir?
>
> A. Yes.

Q. The third thing that Middle South and NOPSI have done to NOPSI's ratepayers has been to operate their system in a way that's enabled NOPSI to have the highest electricity costs on the Middle South system, at least since 1965, to the present, is that true sir?

A. Yes, I believe that is an accurate statement. Their costs have been higher than any other Operating Company since that period of time.

* * *

Q. Now, the fourth thing that Middle South and NOPSI have done for NOPSI's ratepayers is that they have arranged for NOPSI to own absolutely no low cost coal-fired generation at least for the rest of this decade, is that true sir?

A. Yes.

Q. NOPSI presently owns no coal-fired generation, is that correct?

A. Other than their unit power purchase of White Bluff, that's correct which expires or is set to expire when Grand Gulf goes on line.

Q. And that's not an ownership interest of course is it?

A. That's correct, it's not.

(CNO Exh. 33 at 585-860.)

B. NOPSI's Generation Needs And Projections in 1974

NOPSI is and has been the smallest of the four operating companies on the Middle South system.[48] In 1974,

[48] Ark-Mo, which has since been absorbed by AP&L, had a very small load (*e.g.*, 284 MW in 1973). (NOPSI Exh. 35, MLH-5B, 10/4/73 Forecast.)

with an actual peak load of only 869 MW, NOPSI was roughly half the size of MP&L, the next smallest operating company, and less than one-third of the size of AP&L and LP&L, respectively. (NOPSI Exh. 36, MLH-5B, September 11, 1974 Forecast.) While NOPSI's service territory is limited to Orleans Parish, its sister companies serve larger areas throughout their respective states and have supplied power to utilities off the Middle South system. (*See* CNO Exh. 29 at 34-35.) Moreover, during the early 1970's NOPSI was projecting slower growth than its affiliates. The 1974 system forecasts projected NOPSI's load to grow 260 MW, or 27%, from 1975 to 1980. The system growth was projected to be 5828 MW, or 60 percent, during that period. LP&L, the company with the highest projected growth rate, was projecting growth of 2239 MW, or 72 percent. (NOPSI Exh. 36, MLH-5B, 9/11/74 Forecast.)

During the 1970 to 1974 period, NOPSI's forecast of its 1980 load actually decreased by about 60 percent. NOPSI's annual projections for its 1980 load were as follows:

Date of Forecast	Projected NOPSI Peak Load for 1980 (MW)
10/01/70	1800
10/11/71	1570
9/28/72	1570
10/04/73	1405
9/11/74	1210

(NOPSI Exh. 35, MLH 5-A and MLH 5-B.) The total system projections decreased during the same period, but by about only 9 percent. In 1970, the system total load projected for 1980 was 16748 MW, which projection dropped to 15453 MW by 1971 and 15277 MW by 1974. (*Id.*)

In 1974, NOPSI operated eleven oil and gas generating units with a combined capacity of 1257 MW. NOPSI's newest and largest unit, Michoud Unit 3, was completed in 1967 with a capacity of 548 MW—about 60 percent of NOPSI's 1974 peak load. NOPSI's oldest units at Market

Street and Patterson were constructed during the 1930's and 1940's and were expected to be retired in the 1980's.

In 1974, NOPSI was a long company under the 1973 System Agreement. Michoud 3, with a capacity cost of less than $100/kW, was a participation unit. (Tr. 1046.) With no planned capacity additions of its own, however, NOPSI would be a "short" company by 1980, when Grand Gulf I was expected to become operational. (Tr. 1047.)

C. The System's Generation Needs And Projections In 1974

As indicated in the previous section, the Middle South system in the early 1970's was projecting rapid growth of the combined loads of the operating companies throughout the decade and into the 1980's. According to Mr. Hurstell, the system had experienced an annual increase in its peak load of approximately 10 percent in the 1960's. (NOPSI Exh. 36 at 12.) Although its 1974 projection had fallen off slightly, the system was still projecting annual growth approaching 10 percent through 1989. The system estimated that its projection of 9506 Mw for 1975 would be exceeded by 61 percent in 1980 (15277Mw), by 147 percent in 1985 (23456 Mw), and by 253 percent in 1989 (33539Mw). (NOPSI Exh. 36, MLH-5B, 9/11/74 Forecast.)

D. Decision to Build Nuclear Plants—Including Grand Gulf—And Coal Plants

In 1970 and 1971, the MSOC determined that the system load forecasts required the construction of additional generation capacity. (NOPSI Exh. 36 at 6.) According to Mr. Hurstell, the "additional capacity" was needed primarily to serve future growth". (*Id.*) The capacity was also needed for "fuel diversity" (*id.*), which Mr. Hurstell

defined as movement away from reliance on the system's gas and oil fired generation. (CNO Exh. 29 at 214.)[49]

Prior to the 1970's substantially all of the system's generating facilities were built to burn natural gas or oil as a primary fuel. However, throughout the late 1960's and early 1970's, the supply of natural gas for electric generation became increasingly scarce. Pipelines became reluctant to commit to long-term supplies and eventually curtailed deliveries to several of the operating companies. (NOPSI Exh. 35 at 3, 6; NOPSI Exh. 36 at 7.)

In 1970, United Gas Pipe Line Company ("United"), then the exclusive supplier of natural gas to NOPSI, filed a plan with the Federal Power Commission ("FPC") to curtail service to NOPSI. In 1971, United filed an application with the FPC to abandon service to NOPSI. In 1973, the FPC issued curtailment guidelines for natural gas pipelines, such as United; these accorded the lowest priority to utility usage. In 1975, NOPSI's gas contract with United expired and was replaced by a new agreement that substantially increased the price NOPSI was required to pay for natural gas. NOPSI Exhibit 36, p. 7.

Additionally, the Arab oil embargo of 1973 caused a rapid increase in the cost of oil and raised the prospect that the price of oil, like that of gas, would be subject to large fluctuations. (NOPSI Exh. 35 at 61, NOPSI Exh. 36 at 7.)

The foregoing developments caused the Middle South System to decide to move away from oil and gas as generation fuels. (NOPSI Exh. 36 at 12.) Although Mr. Cain testified that the goal of the System was to move to a

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[49] Mr. Hurstell also testified that the additional capacity was further needed to replace capacity which would become obsolete in the future. *Id.* However, in 1974 the system was expecting to retire only 103 Mw—NOPSI's Market Street plant—in the next 15 years. (*See* NOPSI Exh. 36, MLH-5B, 9/11/74 Forecast.)

"50-50 mix" of nuclear and coal generation (CNO Exh. 30(c) at 98), NOPSI itself made no commitment to participate in a coal-fired unit, and had in fact no prospect of participating in such a unit for at least a decade.

In the late 1960's, LP&L and AP&L had committed to install three nuclear units, Waterford 3 (1165 Mw) and Arkansas Nuclear ("ANO") Units 1 and 2 (totalling approximately 1800 Mw), respectively, with completion of the first ANO unit expected to be in 1974. In 1973, AP&L committed to a series of 700 MW coal units, the first of which, White Bluff 1, was scheduled for completion in 1978. (NOPSI Exh. 36, MLH-5B, 11/9/74 Forecast.)

Mr. Hurstell testified that, despite these undertakings, the MSOC determined that additional capacity of 1400 and 1625 Mw should be added in 1978 and 1979, respectively. (NOPSI Exh. 36 at 12.) In 1971, the MSOC commissioned a study of generation alternatives for an additional 1400 Mw of capacity by 1978. The study, entitled "Evaluation of Alternate Generating Capacity Additions," indicated that the most economic choice would be a 1250 Mw nuclear unit. (NOPSI Exh. MLH-6.) On the basis of this study (NOPSI Exh. 36, MLH-6), the MSOC in 1971 determined that two 1250 megawatt nuclear generating units should be constructed. The first was to be at the Grand Gulf site in Port Gibson, Mississippi and to be owned by MP&L. The second was to be constructed by NOPSI at Alligator Point in eastern New Orleans. (NOPSI Exh. 36 at 13-14.)

In 1971, a joint committee of MP&L and NOPSI was organized to begin planning the two nuclear units. Shortly thereafter, the committee retained Bechtel Power Corporation ("Bechtel") as architect/engineer for the units. In 1972, Bechtel advised that poor subsurface conditions of NOPSI's Alligator Point site would result in increased costs for the NOPSI unit. (NOPSI Exh. 36 at 14.) The September 11, 1972 minutes of the NOPSI Board of Directors indicate that Senior Vice President M.L. Cade made a

presentation in which he indicated that it was necessary to abandon the proposed plant due to the results of the Bechtel study. More broadly, he noted, "steeply rising costs of nuclear plants have thrown a cloud on their possible future use on the Middle South System." (CNO Exh. 42 at 2.) NOPSI withdrew the Alligator Point plant from further consideration in August 1972. (NOPSI Exh. 36 at 14.)

In late 1972, MP&L undertook project management of both proposed nuclear units—to be known as Grand Gulf I and Grand Gulf II—at its Grand Gulf site in Mississippi. (NOPSI Exh. 36 at 15.)

E. Commitments To Grand Gulf Under The Availability Agreement

The projected costs of the Grand Gulf units were apparently too large to be financed by any individual company. Mr. Hurstell testified that the projected cost of the first unit alone was $656 million, or roughly one and a half times MP&L's rate base. (NOPSI Exh. 36 at 15.) Mr. Cain testified that it would have been "extraordinarily difficult, if not impossible" for NOPSI and MP&L to finance the two 1250 MW units. (NOPSI Exh. 35 at 8.)

It was determined to utilize the support of all the operating companies to finance the Grand Gulf project. This could have taken one of several forms, but it was decided to create a new MSU subsidiary for this purpose. In February 1974, MSE (SERI) was incorporated. (NOPSI Exh. 35 at 8.) In June 1974, MSE purchased the Grand Gulf project from MP&L for $20 million, but immediately contracted for MP&L to act as agent to design, construct and operate the project. (NOPSI Exh. 36 at 16.) Although the operating companies contemplated that MSE would own other base load capacity, MSE's only ownership interest to date has been the Grand Gulf plant. (*Id.*)

NOPSI and the other operating companies committed the backing necessary to finance the Grand Gulf project

in June 1974, by executing the "Availability Agreement." (NOPSI Exh. 36, MLH-15, Item 2.) The Availability Agreement provided that MSE would use its best efforts to construct the Grand Gulf project (*id.*, Section 2) and, upon completion, make its output available to the operating companies. (*Id.*, Section 3.) In return, NOPSI and the other operating companies committed to pay for the output of the project in an amount equal to the total costs (plus a return on investment) that MSE incurred in supplying the power and energy. (*Id.*, Section 4.) Mr. Cain testified:

> My understanding of the purpose of the Availability Agreement was to contractually bind the operating companies of Middle South Utilities to a fiduciary pledge of financial responsibilities of financing Grand Gulf 1 and 2. (Tr. 482-483.)
>
> . . . .

Section 4 of the Availability Agreement provided that the operating companies' entitlement to, and their obligation to pay for, the output of Grand Gulf would be governed by the "then applicable requirements of the System Agreement (or any agreement substituted therefor)." (NOPSI Exh. 35, MLH-15, Item 2, Section 4; Tr. 486.) Thus, this means that the allocation of Grand Gulf's output and costs would be made such that "short" companies would be obligated to purchase Grand Gulf output in proportion to their capability deficiencies. (NOPSI Exh. 35 at 12-13, NOPSI Exh. 36 at 17-18.)

The Availability Agreement was the first of its kind on the Middle South System. (Tr. 486.) MSE's role as a long company was also unique in that it would have no "capability responsibility" because it had no load. (NOPSI Exh. 36 at 18.) It therefore would always be a long company to the full extent of its generating capacity, and "all

of the Grand Gulf capacity and energy would be purchased by the operating companies in proportion to their relative deficiencies in capability." (*Id. see* Tr. 1045.)

As a result of these circumstances and NOPSI's projected status as a short company at the time when Grand Gulf would become operational, NOPSI knew in 1974 that it would be obligated to purchase a "substantial amount" of Grand Gulf capacity "in the early years when Grand Gulf capacity was relatively expensive." (NOPSI Exh. 36 at 18.) Nevertheless, NOPSI could not determine the amount of its commitment. NOPSI's obligation could not be expressed in numbers of megawatts or as a percentage of the plant, and NOPSI could not ascertain its monetary exposure when it executed the Availability Agreement. (Tr. 547, 549.)

In addition, the Availability Agreement set no purchase price for Grand Gulf's output, or any cap on such price. The contract called for complete reimbursement of MSE's expenses without limitation as to how high those expenses might be, without penalties for cost overruns or limits on the exposure of the operating companies. (*Id.*)

Moreover, the operating companies agreed to pay all of MSE's costs if Grand Gulf were "not in service for any reason." (*Id.*, Section 4.) They agreed to pay if Grand Gulf became permanently shut down, including shut-down and perpetual maintenance costs. They agreed to pay specified amounts if Grand Gulf did not enter into service by December 31, 1982. (*Id.*, Section 4 and 5.) The short companies would be responsible to pay for the entire fixed charges of the plant even if no power were ever delivered from it. (Tr. 442, 569.)

As required by PUHCA, MSU filed the Availability Agreement with the SEC, which approved it by order dated June 4, 1974. *Middle South Utilities*, SEC Public Utility Holding Co. Act Rel. No. 18, 437 (Jan. 4, 1974) (NOPSI Exh. 35 at 8-9; NOPSI Exh. 36 at 16-17; 27-28, 36.) NOPSI did not request or secure the Council's ap-

proval of its entering into the Availability Agreement. (Tr. 487.)[50] In fact, the Council did not become aware of the nature of NOPSI's commitment until 1980.

On the strength of the Availability Agreement, MSE secured the financing needed to construct the project.

MP&L and MSE jointly petitioned the MPSC for a certificate of public convenience and necessity authorizing construction and operation of the Grand Gulf project. The MPSC issued an order granting a certificate in May 1974, and site preparation commenced. (NOPSI Exh. 36, MLH-19-A at 2-14.) In September 1974, the AEC issued construction permits for both Grand Gulf units. (*Id.*) In December construction of the reactor building began, and Bechtel issued its "Definitive Cost Estimate and Schedule" forecasting completion of Grand Gulf I by January 1980 at a cost of $854 million. (*Id.*)

F. Generation Capacity Additions By Other Operating Companies In The 1970's

The first major units, other than oil and gas units, to commence service on the system were AP&L's nuclear ANO Unit 1 and Unit 2 in 1980 (836 MW and 858 MW capacity, respectively). Planning of these units had commenced in the 1960's. LP&L's planning process for its 1104 MW Waterford 3 nuclear unit was running over one year ahead of Grand Gulf, but initiation of heavy construction of Waterford 3 was delayed until late 1975. (Waterford 3 went into service in September 1985). In 1974, LP&L announced its plans to construct another nuclear plant, known as the St. Rosalie project, the two 1160 MW units of which were projected to enter into service in 1983 and 1985, respectively. (NOPSI Exh. 36, MLH-5-B, 9/11/

[50] This circumstance is the subject of a legal action pending in Louisiana state court. *City of New Orleans v. New Orleans Public Service, Inc.*, No. 84-4767 (Civ. Dist. Ct. for the Parish of Orleans).

74 Forecast.) The St. Rosalie project was cancelled, however, in 1975.

AP&L built four coal units known as White Bluff Units 1 and 2 and Independence ("ISES") Units 1 and 2. AP&L initially applied to the APSC for a Certificate of Environmental Compatibility and Public Need for four units at the White Bluff site in 1973. (NOPSI Exh. 40 at 3.) In 1974, AP&L was granted a certificate for two of those units. (*Id.*, p. 4.) In 1977, AP&L and two co-applicants filed for a certificate for two identical units at the Independence site. (*Id.*) The APSC granted that certificate in 1978. (*Id.*, p. 5.)

In the mid 1970's AP&L was apparently experiencing difficulties in financing its construction program, and in August 1975, it halted construction of White Bluff. (NOPSI Exh. 40 at 5.) AP&L was subsequently approached by several smaller power systems and eventually entered into contracts to sell undivided ownership interests in the plant "off the system" as depicted in the following table:

Buyer	Date of Contract	Percentage Ownership	MW Ownership (approximate)
Arkansas Electric Cooperative Corp. ("AECC")	6/27/77	35	560
Jonesboro, Ark.	6/27/77	5	80
Conway, Ark.	6/29/87	2	32
West Memphis, Ark.	1/18/80	1	16

(NOPSI Exh. 40 at 6.) Construction resumed, and the units entered into commercial operation in 1980 and 1981 respectively.

At the time of its ISES application, AP&L had entered into a co-ownership arrangement for the two ISES units

with AECC and the City of Jonesboro. (*Id.*, p. 6.) AP&L subsequently executed similar agreements with three other parties, so that by January 1980 the following systems had ownership interest in ISES:

Buyer	Percent Ownership	MW Ownership (approximate)
AECC	35	560
Jonesville, Ark.	5	80
Conway, Ark.	2	32
West Memphis, Ark.	1	16
Osceola, Ark.	0.5	8

(NOPSI Exh. 40 at 6-7.)

At least as early as January 1980, MP&L was actively considering a purchase of part of AP&L's coal units. On June 1, 1980, AP&L was apparently unable to make payments for the construction costs of White Bluff 2 and ISES 1 and 2. Pursuant to the ownership contracts for those plants, AECC advanced such funds. Absent reimbursement from AP&L by June 1, 1982, AECC would have been entitled to increase its ownership share of the units in proportion to its contributions. (NOPSI Exh. 40 at 7-8.)

Mr. Trumps testified that, in order to assure that the system-owned share of the coal-fired ISES plant would not be reduced, AP&L sold 25% of the ISES units to MP&L. (*Id.*, p. 8.) The two companies executed a Memorandum of Understanding with respect to this sale on July 21, 1980. (*Id.*, p. 9.) ISES 1 entered commercial operation in January 1983, as did ISES 2 in December 1984. (Tr. 987.)[51]

NOPSI made no attempt to explore or seek ownership arrangements for White Bluff or ISES, as did AECC, the

[51] In a separate arrangement agreed to in 1984, AP&L sold MP&L 31% of the output of Independence 1 for a five-year period. (Tr. 813.)

Arkansas Cities and MP&L. (CNO Exh. 31 at 15.) NOPSI did not seek to purchase an ownership interest in any existing or planned system coal plant, except for Wilton I described below. (Tr. 814.) Other than a short-term purchase of White Bluff output (noted below) NOPSI made no effort to purchase coal capacity either on or off the MSU system. (Tr. 815.)

On January 1, 1983, NOPSI made a short-term purchase of approximately 70 MW of the output of White Bluff until Grand Gulf came on line. (Tr. 814.) (NOPSI's witness here, Mr. Louiselle, previously questioned the wisdom of this transaction on the ground the NOPSI would have received substantially the same energy under the economy energy provision of the System Agreement, without payment of capacity charges.) (CNO Exh. 33 at 869.)

There were also plans in the mid 1970's to construct four additional 800 MW coal units in Louisiana, which would become operational in the mid-to-late 1980's. Their construction has repeatedly been postponed. (NOPSI Exh. 36, MLH-5-B.) NOPSI claims that it had plans to take 10% or 80 MW of the output of one of these plants (Wilton 1) beginning in the late 1980's. (Tr. 499-500.) However, no firm commitment was ever made, and it appears that construction of these units was never initiated.

G. Cost Estimates And Forecasting

Bechtel, the principal constructor of and engineer for Grand Gulf, was also responsible for making cost estimates which were submitted to MP&L and then to MSE. (CNO Exh. 20 at 36, 39.) NOPSI wholly relied upon MSE for Grand Gulf cost forecasting. (Tr. 650.) NOPSI had a major interest in the project costs, since it was a committed buyer of power and ultimate payor of Grand Gulf construction costs. (CNO Exh. 28 at 39, 40; CNO Exh. 29 at 112-13.) Nevertheless NOPSI management was apparently unaware of the methods by which cost estimates were made, the underlying assumptions, and whether certain

cost-relevant events were reflected in the cost estimates it received. (CNO Exh. 28 at 40-41; Tr. 709; CNO Exh. 29 at 164.)

Throughout the course of construction, the projected completion costs of Grand Gulf increased relentlessly. (NOPSI Exh. 36, MLH-18.) The Definitive Cost Estimate for Grand Gulf I in 1974 had been $854 million. The official cost forecast issued in December 1978, over a year before NOPSI made a fixed commitment to Grand Gulf, was $1.310 billion. Inexplicably, no official cost estimates were issued during 1979, the year in which the Three Mile Island incident occurred. In February 1980, the official cost forecast for Grand Gulf Unit I was $1.773 billion, over 100% higher than originally estimated. (NOPSI Exh. 36, MLH-19A at II-15 to 17.)[52]

Bechtel's contract allowed it to pass on the rising costs of Grand Gulf to MSE. (Tr. 651.) MSE, in turn, intended to pass on these costs to the operating companies, including NOPSI. NOPSI, in turn, proposed to pass on these costs to the ratepayers. (Tr. 661-62.)

H. Nuclear Plant Cost-Estimation Techniques

The conventional method used by industry to project the completed costs of nuclear plants was "engineering estimation"—a technique that relied upon calculations and judgments as to time, material, and labor, based upon the design of the project. (Tr. 1755.) Bechtel used such a method to make forecasts for Grand Gulf. (Tr. 714.) By the mid 1970's it had become apparent that the engineering estimation method invariably resulted in substantially underestimating nuclear plant costs. (Tr. 1769-70.)

A key problem in nuclear plant cost forecasting lay in making adequate allowance for the expanding and chang-

[52] Completed costs of Grand Gulf I in 1985 were in excess of $3.6 billion.

ing regulatory requirements that were driven by widespread concerns over nuclear safety. (Tr. 1760.) The "contingency" allowances that Bechtel included in its cost estimates contained no allowance for increased costs due to regulatory changes. (NOPSI Exh. 36, MLH 19A at V-35.) NOPSI's management apparently did not know this, because it never undertook to question or examine the cost estimates received.

In the mid 1970's studies of the cost of nuclear plants were released from several sources that used a standard form of statistical analysis ("regression analysis"). These results showed that nuclear plant costs were increasing at rates *far* in excess of those being shown by the industry-sponsored conventional methods. The first such study was published in 1974 by Professor I.C. Bupp of the Harvard Business School in conjunction with a group at M.I.T. (Tr. 1651-52.) Two similar studies were published by William Mooz of the Rand Corporation in 1978 and 1979. (Tr. 1652.) In additional, a book using regression analysis to analyze nuclear and coal plant on-line capacity factors was published in 1976 by Charles Komanoff, a witness here. In 1978 Mr. Komanoff's analysis of nuclear plant capital costs was set forth in state regulatory testimony and reported in *Nucleonics Weekly*, a widely read industry periodical (Tr. 1507-8), and shortly after the Three Mile Island incident, in Congressional testimony. Although NOPSI purported to be familiar with then-current studies on nuclear and coal plant costs (Tr. 757), the contrary appears to be the case. NOPSI remained unaware that the credibility of the methods employed by Bechtel and the industry generally had been seriously undercut by contemporaneous studies and data. (Tr. 721.)

I. Growing Concern Over Gas And Oil As Generation Fuels

During the mid 1970's, there were a number of federal legislative and executive actions taken to discourage elec-

tric utilities' use of oil or natural gas as a boiler fuel. (NOPSI Exh. 35 at 6-7.) In 1978, the Power Plant and Industrial Fuel Use Act, Public Law No. 95-620, 92 Stat. 3289, was passed. It prohibited the use of natural gas in existing power plants after January 1, 1990 and the construction of any major new plants burning either oil or natural gas. (NOPSI Exh. 36 at 8.)

Moreover, NOPSI was having difficulties in obtaining gas as a fuel for its power plants. (CNO Exh. 29 at 78.) Oil and gas prices were continuing to rise. The Iranian revolution in 1979 raised additional concerns about the availability of oil. (Tr. 664.)

The increased price of gas and oil, the Fuel Use Act, the lack of gas, and the Iranian situation did not, it should be noted, alone or together, affect the choice available to NOPSI between nuclear and coal based power generation. (Tr. 677.)

J. The Three Mile Island Incident

On March 28, 1979 an accident occurred at Unit II of the Three Mile Island nuclear plant south of Harrisburg, Pennsylvania, the worst accident in the history of commercial nuclear power generation. Within two weeks, the President approved a "President's Commission on the Accident at Three Mile Island." (Tr. 1272.) The incident focused the nation's attention on nuclear safety issues and resulted in calls for the reorganization of the Nuclear Regulatory Commission and for new actions to ensure nuclear safety. The Three Mile Island incident had an immediate and profound effect on nuclear plant regulation and "came to dominate thoughts in nuclear regulation for the balance of that year and during the time since." (Tr. 1277.)

The report of the President's Commission was released in October 1979, and contained serious criticism of the NRC. (Tr. 1294.) More broadly, the Three Mile Island incident precipitated a wide-ranging review of the whole

structure of nuclear regulation beginning in 1979, and it had major cost implications for nuclear plants, including the Grand Gulf project. (Tr. 1342-43.) The circumstances surrounding the Three Mile Island incident and its impact on NOPSI's situation are discussed in more detail, *infra*.

K. NOPSI's Decision To Take A Large Fixed Share Of Grand Gulf

In January, 1980, approximately nine months after the Three Mile Island incident, NOPSI committed to take large fixed shares of both Grand Gulf I (335 MW) and Grand Gulf II (335 MW), aggregating 670 MW. Its share of Grand Gulf I was approximately 29.8% of the aggregate taken by all Middle South operating companies, notwithstanding that NOPSI had only 9% each of the combined load and combined assets of the system. Not all the events and considerations surrounding the allocation decision are clear, and there have been conflicting statements as to why NOPSI accepted so large a share. In reviewing the facts below, it should be noted that there are two distinct components to the 1980 allocation decision—one making each company's share of Grand Gulf *definite*, since the share had remained unquantified since 1974; and the other setting the *magnitude* of each company's share.

As previously indicated, it had initially been planned that MSE would become a party to the 1973 System Agreement. MSE's entire share of the capacity of Grand Gulf I would become a "participation unit," allocated to the operating companies pursuant to the formulae set forth in the System Agreement. In essence, this was achieved by determining each company's "responsibility" for the total capacity of its system—based upon its relative load—and requiring a company whose owned and purchased capacity was "short" of such responsibility to make payment to a company which was "long." The cost to a short company

was based on the last installed plant of a company that was "long," called a participation unit.[53]

Because the operating companies' load responsibilities would be expected to change with varying load growth, weather considerations, and other factors, and because their capacity ownership would change with the addition and retirement of generating units and purchases by off-system companies, it followed that the companies' allocation of Grand Gulf would also change. Grand Gulf was likely to be less attractive economically in early years—when the relatively undepreciated capital costs were amortized into the wholesale charges for Grand Gulf. Also, in later years Grand Gulf might be more attractive in comparison to plants built subsequently, if construction costs continued to escalate. (Of course, certain assumptions would have to have been made regarding the construction costs of both Grand Gulf and future plants, as well as alternate fuel costs, in order to conclude that Grand Gulf would have comparatively lower costs in the future.)

NOPSI's management testified that NOPSI wanted its share of Grand Gulf to be made definite because NOPSI expected to be "short" and a purchaser of Grand Gulf in the early (expensive) years, and a fixed share would assure

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[53] *See* pp. 59-64, *supra*. To recapitulate, the method of allocation under the System Agreement was roughly as follows. Each company's relative load was determined by averaging its highest non-coincident hourly peaks on certain days. The resulting ratio of this calculation to the aggregate of such calculations for all operating companies on the Middle South System was called its "load responsibility." This ratio, when taken against the total system capacity, determined its "capability responsibility." The "capability responsibility" was then compared to the actual capability owed or under firm contract by the operating company. If the company was "short," it had an obligation to make up the difference by paying capacity-related costs to companies that were long." These costs were based on those of "participation units"—the most recent major generating unit of a "long company." The entirety of MSE's ownership of Grand Gulf capability was to be allocated as a participation unit.

that it could take advantage of the lower costs contemplated in later years. NOPSI also had a general interest in acquiring capacity that was not oil or gas fired in light of then-current conditions. (NOPSI Exh. 36 at 17-20.)

Turning to the magnitude of NOPSI's Grand Gulf share, it appears to have been determined as follows. First, AP&L was released of all of its responsibility to pay for Grand Gulf. According to Mr. Cain, because "AP&L already had in service or under construction base load generating capacity consisting of 2 nuclear and 4 coal fired units, . . . and it was determined that AP&L did not need any additional base load capacity from Grand Gulf." (NOPSI Exh. 35 at 15.) However, it is evident that other approaches could have been pursued. For example, the costs of AP&L's facilities could have been shared by other operating companies, and AP&L could have taken a share of Grand Gulf. A somewhat different version of why AP&L was freed of its Grand Gulf responsibility was given by Mr. Edwin Lupberger, then Senior Vice-President and Chief Financial Officer of MSU, as follows: "Decreasing load growth and political and regulatory pressures have led AP&L to withdraw from the Grand Gulf project." (Tr. 528; CNO Exh. 6.) Similarly, in hearings before the LPSC, NOPSI's witness here, Mr. Louiselle, testified as follows:

> It was contended that AP&L already had either in-service or planned under construction a sufficient amount of base load capacity defined as: nuclear capacity, defined by the Middle South System as base load capacity. In other words, that's how they chose to define it and therefore did not need an additional increment of base load capacity from Grand Gulf. Of course, this reallocation took place *after* everyone realized what the cost of the unit was going to be. And it is my understanding *a certain amount of pressure was brought to bear on Middle South Utilities to get AP&L out of Grand Gulf.*

(CNO Exh. 33 at 856; emphasis added.)

Thereafter, according to NOPSI, studies were performed aimed at achieving an "equitable allocation of the Grand Gulf capacity and energy among the Middle South System operating companies." (NOPSI Exh. 36 at 39.) NOPSI further states that after "extensive discussion" and a "balancing of economic factors," and based on a number of objectives[54] a preliminary allocation was arrived at in January 1980 that gave NOPSI 155 MW of Grand Gulf I and 210 MW of Grand Gulf II.[55]

However, still in January 1980, a different allocation was adopted. NOPSI states that in order to achieve a "minimization of fuel cost differences among the operating companies," additional calculations were made, pursuant to which NOPSI's Grand Gulf shares were substantially increased. (NOPSI Exh. 36 at 40-44.) However, the idea

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[54] Mr. Hurstell summarized these as follows:

1. To move each operating company toward having a relatively proportionate share of coal or nuclear base generating units.
2. To assure the benefits of base generation's lower and more stable fuel prices to those operating companies which otherwise had inadequate base generation.
3. To reduce the disparity in the relative fuel cost of energy among the operating companies.

(NOPSI Exh. 36 at 39.)

[55] The allocation to all companies, including Grand Gulf II, was as follows:

	GG #1	GG #2	TOTAL
AP&L	—	—	—
ARK-MO	50 mw	70 mw	120 mw
LP&L	615 mw	420 mw	1035 mw
MP&L	305 mw	425 mw	730 mw
NOPSI	155 mw	210 mw	365 mw
	1125 mw		

(NOPSI Ex. 36 at 40.)

of basing this increase on the equalization of *fuel* costs, when the underlying *capital* costs of Grand Gulf were far more significant, has been seriously questioned in this proceeding and has never been satisfactorily explained by NOPSI. (CNO Exh. 38 at 40-1; CNO Exh. 29 at 188-89.) In any event, this resulted in NOPSI's taking 335 MW of Grand Gulf I and 335 MW of Grand Gulf II. (NOPSI Exh. 36 at 40-44.)

In January 1980, the chief executive officers of the operating companies approved the new allocation proposals in a signed memorandum. (NOPSI Exh. 36 at 44.) In July 1980, the companies signed a Memorandum of Understanding Re: Allocation of Capability of Grand Gulf I & II ("Memorandum of Understanding") embodying the allocation approved in January. (NOPSI Exh. 36, MLH-15, No. 7.)

Thereafter, the Municipal Electric Association of Mississippi ("MEAM") withdrew from its planned 2.48% participation in the Grand Gulf project. NOPSI's management seemed to have no awareness of or curiosity about the reasons why MEAM withdrew. (CNO Exh. 29 at 137.)

In a Reallocation Agreement of July 1981, the operating companies fixed the allocation of the Grand Gulf project in accordance with the prior Memorandum of Understanding, together with an increment resulting from MEAM's withdrawal. NOPSI's share was set at 29.8% each of Grand Gulf I and II. (NOPSI Exh. 36, MLH-15, No. 11.)

A series of new agreements and amendments to existing agreements followed the fixing of new allocations for Grand Gulf, of which several are described below.[56]

A 1982 System Agreement superseded the 1973 agreement. The new agreement changed the manner of com-

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[56] The Availability Agreement was amended on June 15, 1981 (NOPSI Ex. 36, MLH-15, No. 3(b)) and on June 28, 1984 (*Id.*, No. 3(c)).

puting each company's load responsibility such that it was computed on the basis of the company's 12 most recent monthly loads occurring at the time of the system's monthly peak. Moreover, under the new agreement the participation units were priced on the basis of the "intermediate generation units," defined as units fueled with natural gas or oil, instead of the most recently installed major units of the "long" companies. (NOPSI Exh. 36, MLH-15, No. 4). The change in the System Agreement did not affect the allocation of Grand Gulf fixed for each operating company.

In addition, a Unit Power Sales Agreement ("UPSA") executed on June 10, 1982 provided that MSE would make available to the operating companies, and the latter would take, all of MSE's capacity and energy from grand Gulf I and II, in accordance with their "entitlement percentages" (NOPSI's being 29.8%). It further set forth the terms, conditions and rates for MSE to charge and contained the recital that "AP&L is executing and delivering this Agreement solely for the purpose of consenting to the terms and provisions thereof and will have no rights or obligations hereunder." (NOPSI Exh. 36, MLH-15, No. 5.)

On June 15, 1981, the Power Purchase Advance Payment Agreement was executed and was later filed with the SEC pursuant to PUHCA. It provided that the four operating companies would make an aggregate advance payment of $12,500,000 per month, the share of each to be determined in accordance with its relative payment percentage specified in the Reallocation Agreement, if Grand Gulf I were not in commercial operation by December 31, 1983. Such payments were to be made until the earlier of December 31, 1985 or the date of the commencement of Grand Gulf I's commercial operations. (NOPSI Exh. 36, MLH-15, No. 9.)

L. 1980 Hearings Before The Council

In May 1980, NOPSI filed an application with the Council seeking approval of a "capacity adjustment clause" as part of its retail rate schedule. This clause would have allowed NOPSI to pass through *automatically* in its retail rates the capacity-related costs of Grand Gulf once NOPSI began incurring charges for such costs. The hearings on this application marked the first time that the nature of NOPSI's obligations with respect to the Grand Gulf project was made known to the Council.[57]

At that time, NOPSI's management testified that the proposal would enable NOPSI to pass through the "benefits" of Grand Gulf I to the ratepayers of New Orleans. Mr. Hurstell presented a "study" which he had prepared that purported to show that New Orleans' ratepayers would benefit by $1.9 billion over the first nine years of the plant's operation. (NOPSI Exh. 36, MLH-12A.) However, the principal numbers and assumptions underlying the study were not prepared by Mr. Hurstell, but had been received from MSE, and Mr. Hurstell had not examined them critically.

During the hearing, Mr. Cain was pressed by several members of the Council regarding the propriety of NOPSI, with a total rate base of $210 million, having committed to a liability for Grand Gulf I—then optimistically esti-

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[57] At the prudence hearing, NOPSI's management asserted that the Council had been "informed" about NOPSI's participation in the Grand Gulf project, even though it was conceded that the substance of the arrangement was not put before the Council until the 1980 hearings on the capacity adjustment clause. The record of the September 17, 1980 hearing indicates that NOPSI's president asserted only that the matter had come up in 1972 at a rate hearing in the context of the then-proposed Alligator Point plant, a time when the very different commitment made in 1974 to Grand Gulf had yet to be conceived. *In the Matter of NOPSI Rate Hearing - Public Hearing Electric and/or Gas Rates* transcript of September 17, 1980 (hereinafter "1980 Hearing") at 552-53.

mated at $400 million—"without public consideration" and "without a Board meeting and without advice of counsel" and "without the approval of the Council and without the knowledge of the Council, which is the regulatory authority." 1980 Hearing at 554-45, 559-60, 575. In response, on two occasions Mr. Cain testified that if the Council were to find it inappropriate to participate in taking Grand Gulf power, the ratepayers of New Orleans would not have to bear its cost, since NOPSI would have the option of selling the capacity to other utilities. Specifically, Mr. Cain stated:

> If it is in the wisdom of this Council that it is not appropriate for New Orleans Public Service to participate in this agreement, which they will reflect on through either approval or disapproval of the capacity adjustment clause, through the approval or disapproval of any rate relief we seek as per Grand Gulf, *then NOPSI has the option of selling the capacity and marketing it which, we think will be a very attractive commodity to other electric utilities* who will view this as very, cheap, reliable power for the future.

Id. at 547. (Emphasis added.) He further indicated that

> the Council has the option either to approve our participation in this project through the capacity adjustment clause, and if subsequently it does not then and we file a rate case and they say, 'No, we are not going to allow the recovery of any rates to recover those expenses,' then that's it. They have made the judgment that New Orleans Public Service should not participate in this unit. *And then we will have the option of selling this unit and our portion of it to some other buyer.*

Id. at 560-61. (Emphasis added.)

M. Determinations By The FERC

Two principal issues, *first*, the proper allocation of Grand Gulf as set out in the UPSA, and *second*, the sharing of generation costs as prescribed by the new 1982 System Agreement, were put before the FERC in two separate cases initiated by the filing of the two agreements.[58] Although the cases were tried separately and resulted in separate written opinions of administrative law judges presiding over each case,[59] the FERC jointly decided both cases in Opinion No. 234 (31 FERC ¶ 61,305), and in its opinion denying rehearing in Opinion No. 234-A (32 FERC ¶ 61,425). The FERC rejected the Grand Gulf allocation contained in the UPSA (Opinion No. 234, 31 FERC at 61,655), and it reduced substantially the share accepted by NOPSI's management, ordering the following Grand Gulf I allocation instead:

AL&L	36%
LP&L	14
MP&L	33
NOPSI	17
	100%

(*Id.*)

NOPSI did not intervene as a party until after all the evidence had been taken in the two cases and the Administrative Law Judge had issued his initial decision. No NOPSI witness testified in the proceedings.

As indicated, in September 1980 the Council had been assured by NOPSI's president that the ratepayers of New Orleans were not bound to the costs of Grand Gulf I, and in 1981 the Council authorized a referendum which re-

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[58] The System Agreement case was Docket No. ER82-483-000; the USPA case was Docket No. ER82-616-000.

[59] *Middle South Energy, Inc.*, 26 FERC ¶ 63,044 (Liebman, J.) (1984); 30 FERC ¶ 63,030 (Head, J.) (1985).

sulted in regulatory authority over NOPSI being transferred to LPSC. However, it became evident that the LPSC was not fully protecting New Orleans' interests in the FERC proceedings. The LPSC proposed an alternative allocation scheme that favored ratepayers outside New Orleans. Under the LPSC proposal, LP&L, the largest company on the system (approximately 44% of total system load), would take only 14% of the high-cost Grand Gulf 1 plant. In contrast, NOPSI, which accounted for only 9% of system load, would take 17% of the plant. In December 1982, New Orleans moved to intervene independently in the FERC proceedings, and it recommended that NOPSI receive no more than a 9% allocation. The LPSC's position with regard to the shares to be borne by LP&L and NOPSI, respectively, was ultimately adopted by the FERC.

The FERC held that it had jurisdiction over MSE's sales from Grand Gulf under Section 201 of the FPA, 16 U.S.C. § 824 (Op. 234-A 32 FERC at 61,946-61, 61,947), and authority to modify the allocation contracted for by NOPSI and the other Middle South companies under Sections 205 and 206 of the Act. (*Id.* at 61,949.)

The FERC adopted (Op. 234, 31 FERC at 61,655) the findings of Administrative Law Judge Liebman that the UPSA allocation would cause cost disparities among the companies on the system to the "serious detriment" of NOPSI's and other Louisiana and Mississippi ratepayers. Lieb. p. 27. *Middle South Energy, Inc.*, 26 FERC ¶ 63,044 (1984) (Initial Decision) at 65,104.[60] Thus, FERC held that

[60] FERC Administrative Law Judge Head found that the UPSA allocation would result in NOPSI's having the highest costs on the system on a nine-year average basis between 1983 and 1992 inclusive, and that NOPSI would have the highest annual costs in seven of those nine years. *Middle South Energy Inc.*, 30 FERC ¶ 63,030 (1985) (Initial Decision) at 61,156-61-157. Over the nine years NOPSI's costs would average 61% above AP&L's costs, 36% above LP&L's and 6% above MP&L's. (*Id.*)

the UPSA allocation, to which NOPSI's management had agreed, was unfair and unreasonable and ordered NOPSI's share reduced from 29.8% to 17%. (*Id.*)

Part of the basis on which the FERC undertook to alter the Grand Gulf allocation was that the Middle South companies were operating as "a highly coordinated integrated electric system . . . [which] results in planning, construction and operations which are conducted primarily for the system as a whole." Op. 234, 3 FERC at 61,645. The FERC took note of the joint planning operations of the companies, particularly through their mutual participation in the MSOC. It acknowledged testimony as to the role of individual companies, such as that provided by Mr. Trumps, also a witness for NOPSI here, as follows:

> Mr. Trumps testified that a function of the Operating Committee is to make general decisions as to the size, location, and timing of the units. The specifics as to size and location, he stated, are a function of the individual companies. He described the coordination process as one in which the individual companies participate in the development of the Operating Committee's consolidated power plans. These plans are submitted to and approved by the Chief Executive Officers of the operating companies, and the Boards of Directors of the individual companies approve their own construction projects and expenditures.

(*Id.* 61,647-61,648) citations omitted.

In Opinion No. 234-A, denying rehearing, the FERC rejected charges that it had treated the Middle South system as a "monolithic" entity. Op. 234-A, 32 FERC at 61,952. The FERC stated:

> [Opinion No. 234] repeatedly recognizes the individual operating companies are intimately involved in the planning stages of new generation

> units on the system. It further recognizes that the Operating Committee . . . makes major system decisions in the form of recommendations to the Chief Executive Officers who, in turn, vote on their recommendations, and that the individual companies make final specific decisions necessary to carry out the overall system plan.

Op. 234-A, 32 FERC at 61,953.

On the basis of the degree of system integration and planning, the history of its planning nuclear plants, and the specific history of the Grand Gulf project, the FERC determined that "some form of equalization of nuclear plant costs" was necessary to establish proper rates among the MSU operating companies. Op. 234, 31 FERC at 61,655. It thus adopted the findings of FERC Administrative Law Judge Liebman, "designed to equitably apportion" the total nuclear investment costs of the Middle South System (*id.*), which resulted in giving NOPSI a 17% allocation of Grand Gulf I costs.

The FERC's decision (recently reaffirmed by the agency on remand from the D.C. Circuit) is binding here, but it is not without its own contradictions. The FERC refused to equalize the costs of all generation on the system—notwithstanding that the FERC had rejected the argument that Grand Gulf was an "anomaly" in the regular planning and construction of generating facilities on the MSU system, and had concluded that "all generation additions, including Grand Gulf, have been planned in basically the same manner." (*Id.* at 61,651.) The FERC apparently viewed other cost differences as "relatively minor compared to the cost differences for nuclear generation" (*id.* at 61,656 n. 18) (which seems to ignore the significant cost differences noted earlier), and evidently believed that overall production cost equalization would be "a substantial change from the way costs were previously allocated" (*id.*

at n. 19) (which, however, was also true of the FERC's own nuclear cost equalization formula).

The FERC confirmed that the result of its decision was "not equal rates for MSU affiliates" and it asserted that "the basic nature of regulatory control retained by the states under previous system agreements remains unchanged." Op. 234-A, 32 FERC at 61,952.

The FERC's decision established, by formula, a wholesale electric rate, allocating the cost of Grand Gulf I among NOPSI and its sister operating companies which must be paid to MSE. It did not purport to preempt matters within the Congressionally-preserved state domain of retail ratemaking. In Opinion 234-A, the FERC stated:

> [W]e concurred in [Judge Head's] discussion of the need to balance federal and state interests in exercising our jurisdiction. Furthermore, we think our opinion, taken as a whole, as well as Judge Head's discussion, which we adopted, clearly recognizes the role of the states in regulatory retail electric rates and the need to balance overlapping state and federal electric rate jurisdiction.

32 FERC ¶ 61,424 at 61,951.[61] As noted by Judge McNamara, a provision in those opinions requiring the

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[61] In a subsequent docket concerning an amendment to MSE's tariff, the FERC explicitly rejected the suggestion that it rule on even a minor matter regarding retail ratemaking. *Middle South Energy, Inc.*, Order Accepting Revised Rate Schedule for Filing and Terminating Docket No. ER86-424-000 (June 30, 1986). The FERC held:

> In reference to the Louisiana Commission's alternative request that MSE's wholesale customers be required to voluntarily pass through depreciation savings to retail customers regardless of existing rate settlement or rate orders, the request must be denied since such action would effectively require this Commission to intrude on matters within the

states to pass through Grand Gulf costs is "conspicuous by its absence." *NOPSI I*, slip. op. at 8-9. He found:

> [T]he FERC order merely prescribes interstate wholesale rates that NOPSI is obligated to pay in exchange for its share of Grand Gulf power. More importantly, there is no mandate in the FERC order for state regulatory authorities to pass through the expenses associated with NOPSI's interstate wholesale rates via an increase in intrastate rates.

(*Id.*)

It should be noted that the FERC's opinions do not address the manner, timing, or extent of recovery by operating companies of their Grand Gulf costs as retail rates. They do not address problems posed by the possibility of "rate shock." They do not address the need for a "phase-in" of rates. To the contrary, FERC Administrative Law Judge Liebman, confronted with a proposal for "levelization" (a type of phase-in), declined to exercise jurisdiction over the issue. Rather, he stated that the "design of local retail rates" was within the jurisdiction of the states; that the validity of phase-in plans would turn on its particular facts; and that advance "general pronouncements" on the subject were particularly inappropriate "in light of the clear bright line which the Federal Power Act sought to draw between Federal and state jurisdiction . . ." 26 FERC ¶ 63,044 at 65,148 (1984).

The FERC did not investigate or rule upon the prudence of the management of NOPSI or any of the individual companies in relation to the Grand Gulf plant; nor did the

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> province of retail ratemaking bodies. As noted above, it is our view that entities having jurisdiction over retail rates can take the appropriate action to require a pass-through of depreciation savings.

(*Id.* slip. op. p. 5.)

FERC indicate that it intended to preempt any inquiries into prudence at the local level. As previously indicated, one of the FERC's administrative law judges, confronted with suggestions made by Middle South attorneys that he should make implicit prudence findings, repeatedly stated "I'm not getting into that," and indicated that he could not prevent the issue from being litigated in a state forum. *Middle South Energy Inc.*, Docket No. ER82-616-000, Tr. at 228. Subsequently, the acting chairman of the FERC testified before Congress that:

> The Commission did not determine the prudence of the purchase of power by the Middle South Utilities from the Grand Gulf Nuclear Generating Station in Opinion Nos. 234 and 234-A.[62]

The FERC undertook no effort inquiry to determine what, if any, alternatives might have been available to an MSU operating company when, in light of new information and new events, the economic prospects for the Grand Gulf project changed.

N. Grand Gulf Operations And Costs; Attempts To Dispose Of Grand Gulf

In September 1974, the AEC issued construction permits for Grand Gulf Units 1 and 2, and full-scale construction began. (NOPSI Exh. 36, MLH Ex. 19-A, p. II-14.) In December 1974, Bechtel issued its first Definitive Cost Estimate and Schedule, which forecast completion of Grand Gulf I by January 1980 at a cost of $854 million. (*Id.*)

By the beginning of 1979, the projected cost of Grand Gulf I had risen sharply and its schedule had been significantly delayed. Bechtel's December 1978 Cost Forecast

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[62] Prepared Testimony of the FERC Before Subcommittee on Energy, Conservation and Power, of the House of Representatives Committee on Energy and Commerce, Hearings on Prudence Reviews (March 14, 1986).

No. 5 projected a total cost of $1.310 billion, and its then-current schedule estimated completion by July 1981. (*Id.*, MLH Exh. 19-A, p. II-15.) It was against this background and after the Three Mile Island incident, that NOPSI, in January 1980, entered into an agreement which gave it a large fixed share of Grand Gulf I. (*Id.*, p. 40.)

Thereafter, in February 1980, Bechtel issued Cost Forecast No. 6 and Schedule Revision No. 3 which projected Grand Gulf I's completion by May 1982 at a cost of $1.773 billion. (*Id.*, MLH Exh. 19-A, p. II-16.) On July 21, 1980, the Memorandum of Understanding confirming NOPSI's large fixed share of each Grand Gulf unit was signed. (*Id.*, MLH Exh. 15, Item 7.)

Bechtel's Cost Forecast No. 7 and Schedule Revision No. 4 (forecasting completion by September 1982 for $2.176 billion) was issued in March 1981. (*Id.*, MLH Exh. 19-A, p. II-16.) In July 1981, NOPSI entered into the Reallocation Agreement, slightly increasing NOPSI's share to 29.8% of MSE's 90% share of both units. (*Id.*, MLH-15, Item 11.)

Just a half year later, in March 1982, MSS, as agent for all the operating companies, sent letters to 57 regional utilities offering to sell them all or part of the capacity and energy of Grand Gulf I. (NOPSI Exh. 36, MLH-21.) At that time, MSS projected the plant to be commercially operable by February 1, 1983 at a cost of $2000/kW and $1.6/kWh. (*Id.*) MSS' offer was not accepted by any utility. (NOPSI Exh. 36 at 57.)

Construction of Grand Gulf I was nearly complete by mid 1982. (NOPSI Exh. 36 at 25.) The plant received its low power operating license from the NRC in June of 1982, and commenced fuel loading in July. (*Id.*) Thereafter, the plant was continually subjected to increasing costs and schedule delays associated with regulatory compliance. (*Id.*) Bechtel's estimates increased from $2.888 billion in October 1982 to $3.046 billion in September 1983 and to

$3.424 billion in May 1984. (NOPSI Exh. 36, MLH 19-A, at 16-17.) The NRC issued a full power operating license in July 1984. (NOPSI Exh. 36, MLH Exh. 19-A at II-17.) Grand Gulf I finally entered into commercial operation on July 1, 1985 at a cost in excess of $3.6 billion.

O. NOPSI Files Application For Increased Rates

On May 17, 1985, two days after regulatory authority was formally reinvested in the Council, NOPSI filed an application with the Council to increase its retail rates to recover the costs associated with its Grand Gulf I purchase. NOPSI's application constituted the largest and most complex rate increase proposal ever submitted to the Council. Rather than quantifying a specific level of requested rate relief, NOPSI asked the Council to approve formulary rates which would permit its recovery of all costs billed by MSE each month.

At that time, NOPSI projected that its gross cost associated with a 17% allocation of Grand Gulf I would be approximately $160,000,000 annually. NOPSI projected that the Grand Gulf I purchase would reduce the operation of NOPSI's gas-fired plants and produce off-setting fuel savings of $27,000,000 annually. This resulted in a net Grand Gulf rate increase of $137,000,000 annually.

NOPSI subsequently increased its estimates. In its August 14, 1985 response to the Council's data requests, NOPSI indicated that its 17% allocation would amount to $179,000,000 and, after fuel savings of $27,000,000, would result in a rate increase of $152,000,000 annually (roughly 50% of NOPSI's prior annual revenue requirement of $300,000,000).

On May 23, 1985, the Council introduced Ordinance Calendar No. 12,585, establishing minimum standard requirements for rate applications. It also adopted Resolution R-85-296, giving notice of the introduction of the Standard Filing Requirements Ordinance and requesting that NOPSI

immediately prepare materials necessary for expeditious consideration of its application.

Beginning June 4, 1985, NOPSI submitted to the Council a series of requests to modify or waive the Standard Filing Requirements. The Council met informally with NOPSI to discuss the filing requirements, and the Council introduced a resolution to propose certain changes. On July 11, 1985, at a hearing held to adopt the filing requirements, NOPSI's attorney requested a delay in adoption to afford NOPSI more time for consideration. On August 8, 1985, the Council adopted Ordinance Calendar No. 12,626, fixing standard filing requirements. NOPSI was requested to refile its application within 30 days.

NOPSI made a partial submission of its refiled application on September 30, 1985, two weeks overdue. On October 11, 1985, NOPSI finally completed its filing.

On July 17, 1985, after public hearing and review of its technical consultant's report, the Council adopted Resolution R-85-356A, which authorized NOPSI to issue securities in the amount of $60,000,000. The Council, on its own motion, fixed a date for a public hearing on interim rate relief. Resolution R-85-423.

At a public hearing on July 25, 1985, the Council noticed that no formal request for interim rate relief had been filed by NOPSI. By Motion M-85-326 the Council, in order to prevent any undue hardship and prejudice to the company, invited NOPSI to make an abbreviated formal request for interim rate relief, waived the standard filing requirements therefor, and pledged expedited treatment. Rather than requesting interim relief, NOPSI filed its lawsuit (*NOPSI I*) in federal district court on August 1, 1985. The district court denied NOPSI's motion for preliminary relief by oral order of August 10, 1985 and dismissed NOPSI's complaint by order of September 16, 1985 on the grounds previously indicated.

Pursuant to the district court's order of August 10, 1985, NOPSI filed a formal application for emergency relief on August 19, 1985. After hearings on August 22, 1985 and September 5, 1985, the Council issued Resolution R-85-526, granting NOPSI $28,003,000 interim rate relief.

NOPSI filed an application on September 26, 1985, seeking certain changes in and clarifications of the interim relief order. After public hearings the Council, on October 10, 1985, adopted Resolution R-85-635, which amended and clarified Resolution R-85-526 and granted NOPSI further interim relief. Resolution R-85-635 provided, *inter alia*, that the deferral period for NOPSI's uncollected expenses during the interim rate relief period could commence at the same time that NOPSI's Grand Gulf purchases began, *i.e.*, July 1, 1985. In addition, the Resolution provided that the Council could reconsider the matter of interim relief should future circumstances so merit.

On October 17, 1985, six days after NOPSI completed submission of its rate application in compliance with the Standard Filing Requirements, the Council adopted Resolution R-85-636 ("Prudence Resolution") initiating this investigation of NOPSI's prudence with respect to its purchase of power and energy from the Grand Gulf plant. The Council defined the scope of its inquiry as follows:

> The Council's investigation shall include inquiry into all aspects of NOPSI's prudence regarding its decision to enter into its arrangements to purchase a portion of Grand Gulf I for the purpose of determining what portion, if any, of NOPSI's Grand Gulf I expense shall be assumed by its shareholders, rather than passed through to its retail ratepayers. The Council shall inquire into, *inter alia*, NOPSI's justification for its Grand Gulf I purchase, its consideration of alternatives to Grand Gulf I, the nature of its liability to MSE and MSE's creditors and its efforts to minimize

> its total cost exposure for the purchase. The Council shall also investigate NOPSI's need for Grand Gulf I capacity, NOPSI's decision to mothball and/or decommission existing generating facilities within Orleans parish, the impact of NOPSI's purchase of Grand Gulf I power on its existing generating system, and its impact on its other power supply opportunities. The Council will not seek to invalidate any of the agreements surrounding Grand Gulf I or to order NOPSI to pay MSE a rate other than that approved by the FERC.

Resolution R-85-636 at 4.

The Prudence Resolution requested NOPSI to respond to a series of questions related to its prudence within 30 days, or by November 18, 1985. NOPSI did not submit a response or come before the Council to discuss its concerns about the Prudence Resolution. Instead, it initiated a second lawsuit (*NOPSI II*) in federal district court against the Council on November 14, 1985. This lawsuit was dismissed on December 11, 1985 on substantially the same grounds as *NOPSI I*. Five days later, and almost a month overdue, NOPSI submitted testimony and exhibits in response to the Prudence Resolution.

On February 20, 1986, the Council conducted a public hearing on a settlement proposal submitted by NOPSI on February 5, 1986. Thereafter, the Council and NOPSI conducted extensive negotiations resulting in a settlement of the rate case, previously described.

Meanwhile, testimony on the rate aspects of the settlement proposal was taken. Direct testimony and exhibits of consultants, testifying on behalf of the Council, were submitted on February 20, 1986. NOPSI filed its rebuttal testimony six days later. Hearings were held before John B. Farmakides, the Hearing Examiner appointed by the Council, on March 4, 5, and 7, 1986. The hearings were

adjourned to reconvene at a later date to begin the taking of testimony on the prudence inquiry.

The course of the prudence proceedings and other matters relating to the litigation and attendant appeals have been previously set forth.

PART C. PRUDENCE ANALYSIS

VI. ANALYSIS OF PRUDENCE ISSUES

We now turn to the central issue of how NOPSI's officers and directors discharged their responsibility to manage the company prudently in relation to the Grand Gulf project. The circumstances recited in the preceding section lead us naturally to focus on three critical areas: (A) NOPSI's initial and binding commitment to Grand Gulf, in which it undertook an indeterminate liability for the project; (B) The question of diligence of NOPSI's management in monitoring conditions and information regarding the project and NOPSI's options as the Grand Gulf project went forward; and (C) NOPSI's agreeing to a large fixed commitment to Grand Gulf and its failure to lessen, or hedge against, the risks of its Grand Gulf commitment and secure alternative sources of power, particularly coal-fired, during the "dynamic" period of 1979-1980.

A. NOPSI's 1974 Indeterminate Commitment to Grand Gulf

In 1974, NOPSI undertook a binding but open-ended contractual commitment to Grand Gulf, virtually indeterminate in terms of the monetary exposure it could involve. At issue here is not whether it was reasonable for NOPSI in 1974 to seek an appropriate amount of additional capacity from one or more sources. Rather, we believe that the kind of commitment undertaken here by NOPSI to a single nuclear project cannot reasonably be deemed to have been prudent utility management.

Under the terms of the Availability Agreement, NOPSI was obligated to pay for Grand Gulf in accordance with the allocation formula set forth in the System Agreement. All of the capacity of Grand Gulf owned by MSE was to be a "participation unit" and thus subject to the allocation formula. Because NOPSI had no other planned capacity additions, it would, based on any plausible forecast, be "short" and obligated to take a "substantial amount" of Grand Gulf—particularly in the early years, when it would be "relatively expensive." (NOPSI Exh. 36 at 18.) Beyond this, however, NOPSI did not know how much it would be required to take or what the price would be. This indeterminate obligation would, moreover, mature at a time sufficiently far in the future that the circumstances and NOPSI's exposure could not be accurately forecasted.

NOPSI's Senior Vice President, Mr. Hurstell, testified that in 1974, the magnitude of NOPSI's commitment to Grand Gulf could not be quantified in megawatts (Tr. 591) or in dollars (*id.*) or as a percentage of the plant (Tr. 599), and that NOPSI's monetary exposure was undeterminable:

> Q. Could you have ascertained what your monetary exposure was when you signed up, when NOPSI signed up for the plant in 1974?
>
> A. No.

(*Id.*) He went on to capsulize NOPSI's position in 1974 in the following testimony:

> Q. So there was no question in your mind in 1974 that NOPSI was going to take and pay for some of Grand Gulf?
>
> A. That's correct.
>
> Q. But you didn't know how much?
>
> A. Didn't know how much.

(Tr. 615.)

NOPSI's management took on this indeterminate obligation despite its recognition, recorded in NOPSI's board minutes in September 1972, that "steeply rising costs of nuclear plants have thrown a cloud on their possible future use by the Middle South System." (CNO Exh. 42.) The Council's expert consultant, Mr. Jack Lundberg, characterized NOPSI's situation as follows:

> By signing the 1974 Availability Agreement . . . NOPSI accepted a future fully exposed to 'steeply rising costs' under conditions where such costs were largely beyond its direct control. The Availability Agreement set no limits on NOPSI's exposure.

(CNO Exh. 31 at 13.)

Mr. Lundberg pointed out that "a major purpose of any power supply contract should be to clearly define and set limits on responsibilities and exposure to areas of risk." (CNO Exh. 31 at 13.) In contrast, he noted, the agreement here created risk without limits and definition. It did not define the percentage of the plant to which NOPSI was obligated. NOPSI's obligation could vary over time by 300 percent—that is, from 100 to 300 megawatts. In addition, the ultimate cost of the plant itself was not only difficult to forecast, but beyond NOPSI's control, because it did not own the plant and had, at best, an extremely attenuated position in the management of the project.

The risk posed by the indeterminate nature of NOPSI's obligation was made more serious by the stringency of other terms of NOPSI's obligation. Mr Lundberg noted that under the Availability Agreement,

- NOPSI was fully obligated to pay its share under the System Agreement as of the date Grand Gulf I was 'deemed to be in operation,' whether the plant was in operation or not.

- Similarly, NOPSI was obligated to pay its share of expenses that might be incurred in a "permanent shutdown" of Grand Gulf I including 'perpetual maintenance and surveillance.'
- NOPSI 'irrevocably waived' its rights to raise MSE's legal remedies to bar a suit for specific performance of the Agreement

He concluded, "In view of the stringency of NOPSI's obligations under the Availability Agreement, it was *very imprudent* to enter into an agreement with no fixed allocation of capacity to be purchased." (CNO Exh. 31 at 14, emphasis added.)

Both the circumstances surrounding and the implications of NOPSI's 1974 commitment to Grand Gulf underscore its inconsistency with prudent management. As previously indicated, NOPSI's management was already aware of "steeply rising nuclear plant costs." The rise in such costs was apparent, both absolutely and relatively. Mr. Lundberg testified that while both coal and nuclear projects were faced with new regulations (environmental in the case of coal, and safety-related in the case of nuclear), "the cost of nuclear facilities was rising more rapidly than the cost of coal and there was good reason to believe they would continue to do so." (CNO Exh. 31 at 12.)

Moreover, nuclear projects took longer to complete and were thus subject to less cost predictability and greater exposure to interim changes. In the early 1970's nuclear projects were viewed as requiring a minimum of ten years from conception to completion, while coal projects required from two to four years less time. (*Id.* at 11-12.) In addition, because of safety concerns, nuclear projects "had to be viewed as far more exposed to potential shutdowns due to changing standards and regulations." (*Id.* at 12.)

Mr. Komanoff summarized these circumstances in the following testimony:

> Nuclear power was beset with technical problems and public opposition in 1974. These had already begun to be translated into marked increases in reactor costs and schedules. While other electric generation sources also suffered from disadvantages as to cost, reliability and feasibility, nuclear ventures such as Grand Gulf were probably inherently more risky than alternatives, in 1974. NOPSI's acceptance of an unspecified and ineffectively limited share of Grand Gulf in these circumstances was imprudent.

(CNO Exh. 38 at 26.)

Moreover, NOPSI was the smallest of the operating companies, with a limited service area. Because (as will be discussed hereafter) the magnitude of NOPSI's ultimate Grand Gulf obligation did not depend merely upon its own load growth, but on factors beyond its control, NOPSI's size made it particularly vulnerable to adverse effects if the Grand Gulf project turned out to be uneconomic, as it ultimately did.

NOPSI's indeterminate exposure had obvious debilitating effects. It limited other avenues for diversification. There was no sound reason, other than the burden of its indeterminate commitment to Grand Gulf, for NOPSI not to have sought participation in AP&L's White Bluff and ISES coal projects (CNO Exh. 28 at 112) in the manner, for example, that MP&L did as previously described. Although NOPSI claimed to have plans to take 10 percent of the Wilton coal project in the late 1980's, this would have amounted to only 80 MW, was far in the future, and was at an unknown cost. Moreover, the plans for the Wilton project were themselves subject to derailment if Grand Gulf proved uneconomic, and the project in fact has never materialized.

The unquantified nature of NOPSI's obligation impeded, from the outset, not only NOPSI's ability to make other

plans but also its ability to protect itself if the project went sour. The unspecified amount of the commitment would have made it more difficult for NOPSI to structure a sale of its Grand Gulf power if circumstances merited its doing so. In fact, NOPSI relied upon the indeterminate size of its own allocation to argue against the testimony here that NOPSI should have sold substantially all of its Grand Gulf position in 1979 and 1980. (NOPSI Exh. 43 at 9.) That argument, however, merely highlights the imprudence of NOPSI's management in accepting indeterminate liabilities at the outset of the Grand Gulf project.

NOPSI's expert witness Mr. McWhinney acknowledged the "indeterminacy of the allocation" undertaken by NOPSI, but sought to defend it on the basis that NOPSI's share of Grand Gulf would increase in relation to NOPSI's load growth, and decrease if it had lower growth. It was, he thought, "preferable to a fixed share." (NOPSI Exh. 53 at 25-26.) However, on cross-examination, Mr. McWhinney conceded that NOPSI's Grand Gulf responsibility would change, not merely in relation to its own load growth, but in relation to other factors not involving NOPSI's growth or within NOPSI's control. For example, its share would be related to the low or high load growth of other companies; the retirement or abandonment of other generation resources on the system; and any changes in construction plans of new units. (Tr. 1741-42.) At the conclusion of this line of inquiry, Mr. McWhinney conceded as follows:

> Q. . . . So NOPSI's future obligation to take from Grand Gulf wasn't related solely to NOPSI's own load growth, isn't that right?
>
> A. That's correct.

(*Id.*)

There were clearly alternatives that NOPSI could have pursued, but there was no evidence that it did so. For

example, it would have been rewarding to have found evidence that NOPSI's management had insisted from the outset that NOPSI should not have to accept more than 9 percent of the ultimate cost responsibility—an amount related to its relative size and relative ability to bear risk (CNO Exh. 38 at 13) for Grand Gulf. Moreover, had limits on NOPSI's commitment been imposed at the *outset* of the project, and thereafter formed part of the factual record before the FERC, it is highly doubtful that the FERC would have felt free to allocate a large portion of Grand Gulf I to NOPSI.

NOPSI had other generation options for meeting its forecasted load so that it was not required to commit so extensively to a single nuclear project. Mr. Lundberg testified that NOPSI should have planned to diversify its additional resources; that it should have limited its Grand Gulf commitment to an amount on the order of 100 MW and satisfied the balance of its capacity needs through other projects on the system—pursuing a mix of fuel and project sources; and that it should have sought participation in one or more of AP&L's four proposed coal-fired facilities. (CNO Exh. 31 at 16-18.) He cited, as a contrasting example, the municipal utility operations of the City of Jonesboro, Arkansas which, during the same time period, reviewed more than 50 different power resources and ultimately acquired a 5% share of AP&L's White Bluff and ISES units. (CNO Exh. 31 at 16-17; NOPSI Exh. 38 at 87.) NOPSI apparently made no such investigation and did not explore participation in such units.

Despite the enormity of its 1974 commitment and its recognition that Grand Gulf was an unprecedented and "major" commitment of the company, NOPSI did not inform the City Council of its obligations under the Availability Agreement until 1980. (CNO Exh. 31 at 9.) Had NOPSI's management for any reason, whether or not justifiable, felt timorous about protecting the welfare of NOPSI's ratepayers because of pressure from MSU or others,

that circumstance could have been overcome by a timely intercession of the Council, which was empowered to regulate NOPSI. The secretiveness of NOPSI's management was itself imprudent and compounded the deficiencies we find in its actions and inactions.

Despite NOPSI's serious imprudence in this area, other events which have taken place at the federal "wholesale" level have limited our remedial powers. In its Opinions 234 and 234A, the FERC has set NOPSI's share at 17 percent of Grand Gulf I. We interpret existing law as requiring that the federally-determined allocation of Grand Gulf I costs, resulting in a wholesale rate, be binding on NOPSI and upon the Council. We therefore base no rate remedy upon the imprudence of NOPSI's management in accepting an indeterminate share in 1974 and in creating circumstances which left NOPSI subject to a formulary allocation that is nearly twice its relative size in the system. However, NOPSI's ratepayers should have no doubt that, in our opinion, their interests were neither well considered nor well served by NOPSI's management in the critical undertakings that bound NOPSI to the Grand Gulf project in 1974.

B. NOPSI Failed to Maintain Prudent Oversight Of Its Grand Gulf Obligations

As a public utility committed to purchase a substantial portion of the power of the Grand Gulf project, NOPSI should have had great concern with the progress and cost of the project. (CNO Exh. 28 at 37; CNO Exh. 29 at 112.)[63]

[63] There is, however, good reason to doubt that the incentives necessary for cost control were present here. It was expected that the costs of Grand Gulf would be passed on from Bechtel, to MSE, to NOPSI, and then to ratepayers—untempered by competition at any level. It is questionable whether this pass-through system is likely to generate the same incentives to contain and monitor costs as would be present in an unprotected commercial environment (Tr. 651-2; CNO Ex. 29 at 113), notwithstanding the prospect of subsequent administrative review.

NOPSI concedes that its commitment to Grand Gulf was a "major commitment." (Tr. 622.) It was certain that NOPSI would have an obligation to take and pay for some amount of Grand Gulf without any set limits on the price it would pay. Therefore, it had an obligation to monitor that exposure carefully during the construction of the project. In this regard, the conduct of NOPSI's management was plainly inadequate.

In 1974 NOPSI had approximately 30-40 employees comprising its upper management and associated staff (Tr. 622), a number which had grown to approximately 90 by the date of the hearing (Tr. 594). There were, nevertheless, no organized systems or procedures for maintaining oversight of NOPSI's Grand Gulf commitment. Despite the fact that information with respect to Grand Gulf came in from a variety of formal and informal sources, there was no central or even regular procedure for handling information that was received. (*Id.*, CNO Exh. 29 at 72; CNO Exh. 28 at 34-35.) Moreover, there was no committee or other instrumentality to deal in a coordinated way that information, nor was there any committee established within NOPSI to assess developments at the project from the perspective of NOPSI's interests. (Exh. 29 at 57.)

Although the cost forecasts for Grand Gulf showed an unremitting increase (CNO Exh. 28 at 64), there was apparently no one at NOPSI responsible for critical review and analyses of the cost estimates. (CNO Exh. 28 at 70.) There was no evidence that NOPSI questioned any of the assumptions that underlay, or the components making up, the cost estimates. NOPSI's president, Mr. Cain, testified:

> Q. As a buyer of the service or product that was being offered, and being the recipient of information as to how much you, as a buyer, would have to pay, you had some concern, I take it, about making sure that the cost es-

timates were accurate, or responsible; isn't that right?;

A. Yes, as part of an overall electric utility holding company which was responsible for the development of the plans for the construction of the plant, the justification for the need for the plant, and other aspects as part of that system. We were a buyer.

Q. You were a buyer, and you had that concern?

A. Yes.

Q. So, as these cost estimates came in, did you or anybody else acting under your direction ask about the assumptions that underlie those estimates, and the components of the estimates?

A. We could have, sir. I don't know.

Q. Do you recall a discussion where that took place?

A. No, sir.

Q. Did you ever direct any employee of NOPSI, officially or otherwise, to contact anybody with respect to a particular cost estimate?

A. No, sir, not that I can recall. I could well have, but I don't recall an instance.

(CNO Exh. 28 at 40-41.)

There was no coordinated review of cost increases. Apparently, Mr. Hurstell was the only person on the routing list for the cost forecasts which Mr. Cain received. (CNO Exh. 29 at 92-93.) As far as Mr. Hurstell knew, there was no one at NOPSI who sought to determine whether the cost forecasting was reliable. Instead, NOPSI relied entirely upon MSE and Bechtel. (Tr. 650.) This was so de-

spite the fact that Bechtel had an obvious self interest in the continuation of the project (CNO Exh. 28 at 66-67), and was engaged under a contract which allowed it to pass through its costs (Tr. 651).

Despite NOPSI's assumption that it could rely entirely upon MSE, Mr. Cain testified that he never participated in any discussions at the MSE board meetings, or elsewhere, dealing with the reliability of Bechtel's estimates (CNO Exh. 28 at 70) and was not aware of anybody within MSE engaged in a critical analysis of Bechtel's forecasts and their underlying assumptions. (*Id.* at 71.) (MSE itself was largely a shell organization, having a staff of no more than two to three persons and no office space of its own. Those who served in elected capacities were employees of other companies in the Middle South System.) (CNO Exh. 28 at 91-93.)

After the Three Mile Island incident occurred in March 1979—a critical event for nuclear reactor construction and costs—NOPSI failed to act prudently to assess the evolving circumstances and protect its interests. Mr. Cain testified that there were no meetings held at NOPSI with regard to the impact of the Three Mile Island incident. (CNO Exh. 71-72.) Mr. Cain never called for a cost estimate to assess any possible impact of the Three Mile Island incident on the Grand Gulf project and NOPSI's interests. (*Id.* at 74.) Instead, in the wake of the Three Mile Island incident, and despite the absence of a revised cost forecast being issued in 1979, NOPSI, in January 1980, acceded to a share of Grand Gulf that was more than three times larger than its relative size in the Middle South system.

The next cost forecast was issued in February 1980, but Mr. Cain was not aware of why it had taken so long for a new cost estimate to be prepared. He did not know whether the new 1980 forecast purported to reflect any increased costs threatened by the Three Mile Island incident, and he did not recall questioning at the time whether

the forecast did so. (*Id.* at 74-75.) While Mr. Cain assumed that someone in the Middle South System was responsible for tracking the cost of finished nuclear plants during this period of time, he could not recall who had that responsibility. (*Id.*)

Mr. Hurstell, who was the person principally relied upon by Mr. Cain with respect to Grand Gulf (CNO Exh. 28 at 12), testified that during the entirety of the year 1979, NOPSI "did not have any particular meetings" with regard to the possible impact of Three Mile Island. (CNO Exh. 29 at 84-85.) Mr. Hurstell had no appreciation that Three Mile Island might result in substantially increased costs. He testified,

> Q. Your testimony is that in the year 1979 you had no appreciation that Three Mile Island might result in substantially increased costs with respect to Grand Gulf?
>
> A. I had no idea, no, sir.

(Tr. at 668.) Moreover, it is Mr. Hurstell's position that Three Mile Island was blown up by the press. He testified:

> Q. Are you saying a disproportionate amount of attention was focused on Three Mile Island by the press?
>
> A. In retrospect I would say, perhaps.

(Tr. 789.)

Throughout these events, it appears that NOPSI's own board of directors was minimally involved and extremely passive. While Mr. Cain testified that NOPSI's board "may have been informed as to what the latest estimate of costs would be" (CNO Exh. 28 at 97), he testified that no discussions emanated from members of the board with regard to any position that NOPSI should take or attempt to take with respect to its participation in the Grand Gulf project. (*Id.*) He testified also that the board did not ask for any

information other than what had been provided to them and the there were no questions raised by them as to the implication of Grand Gulf costs for NOPSI's ratepayers. (*Id.* 97-98.) The board never raised the issue of the reliability of cost estimates that they were receiving. (CNO Exh. 19 at 61-62.) Moreover, several directors recalled no discussion of the impact of the Three Mile Island incident on the Grand Gulf project or NOPSI's obligation therefore. (CNO Exh. 17 at 19-20; CNO Exh. 27 at 39.) NOPSI's board was not consulted in advance of NOPSI's entering into the key agreements effecting the major reallocation of Grand Gulf obligations among the operating companies in 1980. Rather, the board merely ratified the documents afterwards. (CNO Exh. 28 at 119-120.)

NOPSI never sought to determine the impact of Grand Gulf on the ratepayers of New Orleans and never sought to bring the issue of ratepayer impact to the attention of the MSE board. (CNO Exh. 28 at 47.) NOPSI's management held no meetings to discuss the subject of the cost impact of Grand Gulf on NOPSI's retail customers. (*Id.* at 54.) NOPSI put no one in charge of dealing with its relationship with the ratepayers of New Orleans, and Grand Gulf apparently became a subject of concern only just prior to its commercialization.

In relevant areas, such as the possible purchase of coal fired power as an alternative, NOPSI was passive, so that if no "offers" were made to it by others, NOPSI assumed that no opportunity existed. During the discussions leading up to NOPSI's taking a large fixed share of Grand Gulf in 1979-1980, NOPSI apparently made no proposal of its own. (Tr. 461-62.) Indeed, its president had not even determined if NOPSI could object to a proposal put "forward or adopted by the system." (Tr. 464-465.)

Throughout the presentation of evidence regarding these events, there has been a curious and incredible lack of relevant documentation. Despite the fact that NOPSI's

president, Mr. Cain, testified that he made and passed around notes and sheets of information regarding Grand Gulf, none whatever were produced by NOPSI in response to the Council's discovery requests. Although Mr. Cain relied primarily upon Mr. Hurstell in discussing matters relating to Grand Gulf (CNO Exh. 28 at 12), Mr. Hurstell claims to have prepared no memoranda regarding Grand Gulf during the many years of the project, with the exception of the "study" prepared in 1980 (MLH Exh. 12). That "study" utilized cost figures for Grand Gulf supplied by an unspecified source at MSE and was designed to persuade the Council to authorize an automatic pass-through of Grand Gulf capacity costs. (Tr. at 693-694). Moreover, although NOPSI's management made vague references here to supposed MSE evaluations of the economics of Grand Gulf and the impact of Three Mile Island, there were virtually no memoranda produced evidencing an exploration of these issues.

It is difficult to avoid reaching the regrettable conclusion here that document production by NOPSI in this proceeding bears the indicia of expurgation and selective production. The absence of such materials, or the failure to produce them, is highly disturbing.

To recapitulate, there is no indication in the record here that NOPSI organized itself responsibly to deal with information and events pertaining to the Grand Gulf project. Its own board was passive and was consulted on key events after the fact. It never sought to assess the impact of Grand Gulf on NOPSI's retail ratepayers; never sought aggressively to pursue options that might have been available to the company; never questioned cost assumptions; was unconscious as to the potential impact of Three Mile Island; did not advance positions favorable to NOPSI in MSE board meetings or other "system" organizations; and ultimately, it failed to protect its own ratepayers by accepting a share of Grand Gulf which one of its own experts

has flatly testified was imprudent (CNO Exh. 33 at 853-54) and was found to be unreasonable by the FERC.

C. NOPSI Failed to take Prudent Actions in the Critical 1979-1980 Time Frame.

Summary of Analysis

1. During 1979, the Situation Changed Radically.

Problems that affected the rationale underlying, and economics of, NOPSI's relationship to Grand Gulf had been growing throughout the mid-1970's. By the end of 1976, NOPSI had made a substantial downward adjustment in its forecasted load. Concurrently, the forecasted costs of Grand Gulf had risen to almost 70% above original estimates. (CNO Exh. 31 at 21.) The need to meet load growth had been the principal rationale for Grand Gulf. While the FERC has suggested that the rationale shifted to one of fuel diversification as load forecasts fell, the increasing cost burden of the Grand Gulf project in fact threatened such diversification.

By end of 1978, projected completion costs of Grand Gulf I were $1,048 per KW, more than *double* original estimates. Increasing nuclear plant costs were not, as NOPSI's management professed to believe, merely the result of inflation. Rather, knowledgeable sources in the industry were reporting that regulatory design and safety requirements—characterized by the industry itself as "even-expanding"—were greatly increasing the duration and cost of nuclear plant construction. (CNO Exh. 38 at 58.) As an example, one study stated "The most significant effect on nuclear plant costs has been compliance with revisions to the NRC regulations and the 100 plus regulatory guides." (Ebasco Services, "Dramatic Changes in the Costs of Nuclear and Fossil-Fueled Plants," Sept. 1978 pp. 6-7, CNO Exh. 38 at 58.)

In addition, important new analyses of nuclear plant cost trends conducted at MIT, the Rand Corporation and by

Mr. Komanoff undercut the conventional industry method of estimating nuclear plant costs and showed that real costs were rising at much higher rates. (*Id.* at 48; Tr. 1823-1825.)

On top of these trends was the Three Mile Island incident in March 1979. The incident threatened major regulatory consequences for nuclear plants, which in turn meant higher nuclear plant costs.

According to Mr. Hurstell, the 1979-80 period was a "very dynamic time" (CNO Exh. 28 at 60), but he seemed inexplicably blind to the skyrocketing costs of nuclear plants, mentioning only other factors—*i.e.*, the curtailment of natural gas, the questionable availability of oil, the Fuel Use Act, and the increasing cost of oil and gas. (*Id.* at 75-79.) These factors, it should be noted, were neutral on the choice between coal and nuclear that confronted, or should have confronted, NOPSI's management. (Tr. 677.)

2. What NOPSI Did and Failed to Do.

It is useful to evaluate the corporate "state of mind" with which NOPSI approached the significant events of 1979-80. As indicated in previous sections, NOPSI (a) never questioned cost estimates; (b) never questioned assumptions underlying cost estimates; (c) did not know if the cost estimates it received after March 1979 included a factor reflecting potential cost increases attributable to Three Mile Island (CNO Exh. 28 at 164); (d) never sought a cost estimate to reflect Three Mile Island; (e) never held a meeting to discuss potential impact of Three Mile Island; (f) relied on the "system" to make cost estimates and to deal with Three Mile Island, but could not point to any particular agenda item at MSE meetings that dealt with either issue; and (g) never sought to determine the impact of Grand Gulf on NOPSI's ratepayers.

NOPSI, and apparently MSE as well, was either oblivious to, or intentionally ignored, statistical analyses showing major upward cost trends in nuclear plants even before the Three Mile Island incident. (Tr. 761.) Moreover, NOPSI's management apparently believed that the Three Mile Island incident was overblown and had "no idea" that it might result in substantially increased costs. (Tr. 668.)

There is no evidence that NOPSI even explored any alternatives. (CNO Exh. 31 at 21-22.) Instead, in January 1980, within 9 months after Three Mile Island, NOPSI acquired a large fixed share (about 29.8%) of Grand Gulf, an unfinished nuclear plant. (Tr. 686.)

Instead of critically examining its circumstances, NOPSI's objective was to put the best face on its Grand Gulf commitment in order to secure an advance, automatic pass-through of Grand Gulf costs to its ratepayers before the true costs were known. In 1980, with costs continuing to rise, NOPSI filed an application with the Council seeking approval of a "capacity adjustment clause" that would have enabled it to pass through Grand Gulf costs in retail rates automatically. (Tr. 692-4.) At that time it presented a "study" prepared by Mr. Hurstell (NOPSI Exh. 36, MLH 12A, 12B) that purported to show $1.8 billion in benefits to the ratepayers from Grand Gulf over 12 years (Tr. 682-3). Its purpose was to persuade the Council that "even with this increased cost of Grand Gulf that it would be economical." (CNO Exh. 29 at 80.)

NOPSI's management did not know whether or how Three Mile Island effects were reflected in the cost estimates (*Id.* 161-164), but relied entirely on MSE to supply cost information. NOPSI engaged in no critical examination of the information it received. (*Id.* Tr. 683; 164). Moreover, the key chart in Mr. Hurstell's "study" presented to the Council in 1980 was itself misleading. The columns on the chart were labeled so as to compare "fossil only" generation to a "fossil and nuclear" mix. Although the term "fossil" normally includes coal-fired power (Tr. 689), in Mr. Hurstell's chart, substantially no coal-fired power

was included. (Tr. 688-689.) Thus, the chart could easily have been misunderstood as showing that nuclear power costs had been analyzed and compared to coal-fired alternatives, with favorable results, but this was not the case.

Set on justifying Grand Gulf, NOPSI's uncritical commitment undoubtedly impaired any disposition to explore opportunities to diversify (Tr. 679). Under its own plans as they stood in 1980, NOPSI was to acquire only 80 megawatts of coal, almost a decade later (*Id*; CNO Exh. 33 at 859)—assuming, of course, that NOPSI or others had the financial resources to build new coal plants at that time. However, Grand Gulf I was to exhaust those resources.

3. What NOPSI Should Have Done.

In 1979, and following the Three Mile Island incident at the latest, NOPSI should have engaged in a major reevaluation of its power supply commitments (CNO Exh. 38 at 18). NOPSI's own expert witness, Mr. McWhinney, testified that NOPSI should have "used all information that was available" (Tr. 1801) and that in reaching a decision prudently, "all available, relevant, meaningful information should be brought to bear" (Tr. 1877). NOPSI failed to inform itself adequately, and was wholly unaware of important materials bearing upon nuclear plant costs directly relevant to its Grand Gulf commitment.

Had NOPSI's management undertaken to become adequately informed, it would have concluded, at the least, that Grand Gulf posed a major risk to it and was likely to be uneconomic and result in a major liability. Mr. Komanoff's testimony, which we find credible, is to the effect that such a review, if undertaken in 1979, would have shown that NOPSI's Grand Gulf I commitment could cost NOPSI an excess lifetime cost of $320 million over a coal-fired alternative, even using certain "conservatisms" favorable to NOPSI's position on Grand Gulf. (CNO Exh. 38 at 9.)

NOPSI should have attempted to minimize these Grand Gulf risks. It should have actively pursued available generation alternatives. In particular, NOPSI, instead of taking a 29.8% fixed share of Grand Gulf, NOPSI should have sought the least amount possible. But even assuming that NOPSI was required to take a share as a matter of "system" responsibility (or under a FERC ruling[64]), it should have sought to lessen and spread its risks through off-system sales of its share of Grand Gulf, just as it said it could do. (*Id.* at 10.) At the same time, NOPSI should have contracted for coal-fired sources of power to diversify and support its program of displacing oil and gas fired generation. (*Id.*)

Detailed Analysis

4. NOPSI's Failure to Deal Realistically with the Rising Cost of Grand Gulf; the "Ostrich" Policy.

The record in this case shows that the cost forecasts of Grand Gulf were skyrocketing even before Three Mile Island incident (CNO Exh. 36, MLH-19A at II-14 and 15). Thus, estimated construction costs had risen to $1.3 billion by December 1978, compared to the original estimated cost of only $.854 billion in 1974. Throughout this period, NOPSI never questioned the underlying assumptions of, or undertook any critical analysis of the estimated costs (CNO Exh. 28 at 40-41), despite its large stake in the outcome. NOPSI purported to rely upon cost estimates received through MSE, without examining their basis or validity, and it used them in seeking an automatic pass-through from the Council in 1980 (NOPSI Exh. 36, MLH-

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[64] NOPSI's management has testified throughout these proceedings that it expected the FERC ultimately to make the managemental decision as to how to allocate the costs of Grand Gulf—but this viewpoint, at best, matured only in later years and appears substantially to be hindsight. The idea of leaving major management decisions to a government agency is itself questionable.

12 and 12A), at which time it projected great benefits from Grand Gulf. (CNO Exh. 29 at 108).

During the period of time in which Grand Gulf was constructed, cost forecasting by those involved in the nuclear industry was based on the so-called "engineering estimation" method. It was, in general terms, similar to the method by which a contractor estimates the cost of building a house (Tr. 1755). NOPSI's witness Mr. McWhinney described the process as follows:

> Q. . . . What was the technique that was used by the industry?
>
> A. The technique, as I understand it, is that an engineer will estimate the amount of material by various quantities and the amount of labor required to design and construct a plant, and using specific unit costs, extend those costs to come up with costs to complete, usually adding some kind of management reserve or contingency to come up with a cost estimate, just the same way a builder estimates the cost of building a house for you. (Tr. 1755.)

There were several potential problems with the engineering estimation method. It was judgmental and susceptible to underestimation. It relied upon estimates as to how long various phases were going to take and how much elements were going to cost. Moreover, judgments had to be made as to the regulatory environment. Regulation affecting nuclear plant construction and safety matters had been recognized as the principal cause of escalating real costs of nuclear plants (Tr. 1760; CNO Exh. 38 at 58-59), but absent an empirical basis for estimating their effect, there was considerable opportunity for underestimation.

A far deeper problem affecting the engineering estimation method was that it was being invalidated by the

facts, as conceded by one of NOPSI's own witnesses, Mr. McWhinney:

> Q. [O]utcomes are useful to evaluate the validity of a technique for estimation, aren't they?
>
> A. Yes, that's correct.
>
> Q. . . . Was the engineering estimation technique being validated by the outcomes?
>
> A. Mr. Wruble, the answer to your question is that the plants cost more than they were estimated ten year ago.
>
> Q. They cost more. They cost more, did they not, on an annual basis that exceeded the rate of inflation.
>
> A. I think that's correct.
>
> Q. All right.
>
> So that as I understand it, your testimony is that while the—the people in the industry were using engineering estimation to project a completed cost of a nuclear plant, the cost was always coming in substantially higher than the original estimate. Can you think of a case where it didn't?
>
> A. No, I can't.

(Tr. 1769-70)

Beginning in the mid-1970's, a number of statistical studies were made public that undercut the conclusions and validity of the engineering estimation method. These studies showed that nuclear plant costs were increasing at a rate that was far in excess of both inflation and conventional cost estimates. The first was published in December 1974 by Professor I.C. Bupp of the Harvard Business School in conjunction with researchers at the

Massachusetts Institute of Technology. (Tr. 1651-2; NOPSI Exh. 38 at 46.) There followed two studies by William Mooz, published by the Department of Energy and the Rand Corporation respectively, in 1978 and 1979. (Tr. 1652; NOPSI Exh. 14 at 46.) These studies were widely distributed and discussed in the academic community, in federal agencies, at the Electric Power Research Institute, and other institutions. (*Id.*) In addition, Mr. Komanoff, a witness here, published in 1976 a book applying statistical analysis to nuclear and coal plant on-line performance (Tr. 1654). Thereafter, he used the same analytical methods to assess nuclear plant capital costs and made his conclusions known in testimony before a state regulatory commission in October 1978 (Tr. 1507). He disseminated his findings in a speech in September 1978, and they were in turn reported in *Nucleonics Weekly* (Tr. 1507), a publication which was read or known by "most people in the industry." (Tr. 1842-43). Drafts of material which became Mr. Komanoff's 1981 book, *Power Plant Cost Escalation* ("*PPCE*"), were circulated in 1978. (Tr. 1508.) In addition, Mr. Komanoff testified before the Subcommittee on Energy and the Environment of the House Interior Committee in July 1979 as to the results of his statistical analysis of nuclear and coal plant costs and the implications of Three Mile Island. (Tr. 1663-4.)

The statistical method used by all three of the foregoing analysts is a widely accepted technique called "regression analysis." In contrast to the "engineering estimation" method, it utilized hard data from completed nuclear plants to measure the actual rates of increase in costs during the period and also to produce estimates of the effect on costs of various causal factors. (Tr. 1468).

NOPSI's witness Mr. McWhinney characterized the significance of the results being reached by use of this technique as follows:

> Q. Let me do it this way. William E. Mooz, in his Rand Corporation study in 1978, determined that nuclear costs were increasing at a rate far in excess of that which had been presupposed in engineering estimates made during the 1970's, did he not?
>
> A. Yes, he did.
>
> Q. And Mr. Komanoff at the same time period has done exactly the same thing, hadn't he?
>
> A. Yes . . . . .

(Tr. 1782).

Mr. Komanoff described the significance of his work as follows:

> Q. So, as I understand it, your determination as to cost increases in 1973 was not a projection of the future, but was based on hard data as to what in fact had occurred during the period of your studies?
>
> A. That is correct.
>
> Q. Now can you tell me roughly what the annual cost increase implied by the aggregate cost increase which you mentioned was?
>
> A. Yes, sir. Converting this 150 percent increase over the total seven year completion period can be done in two different ways. If that total cost increase is broken down by date of completion, then the rate of increase averages about 13 percent a year. If instead it's broken down by the date of construction start, the increase is 24 percent a year . . .
>
> Q. Let me understand the significance of this. As I understand your testimony, you found that there were real cost increases in nuclear

plants, not inflationary cost increases, in the range of 13 percent annually, or 24 percent annually, respectively, based upon the categories you mentioned, isn't that correct?

A. Yes, sir.

Q. Now, this evidence that you brought forward based on statistical examination, was that consistent with or adverse to the figures that the nuclear industry had been giving out with respect to how much nuclear plants were going to cost?

A. These figures contradicted the prevailing beliefs and statements at the time concerning the rates of past increases in nuclear costs, the likely future costs of nuclear plants, and the relative competitiveness of nuclear and coal.

Q. And the implication thereof was that nuclear plants were going to cost more.

A. Yes.

(Tr. 1470-1475.)

The reason offered by NOPSI for its—and apparently MSE's—failure to make any use of regression analysis to develop the probable completion costs of Grand Gulf is its contention that the method "does not properly reflect what NOPSI knew or should have know in 1979" because it was "a new method . . . that was not at the time in wide use in the industry" (NOPSI Exh. 53 at 5). The method, NOPSI's witnesses contended, "was not widely known . . . and is, therefore, not an appropriate technique to use in a retrospective analysis." (*Id.* at 29).

While NOPSI witnesses (Tr. 1773) and its counsel (*see* Tr. 1641-1648) stated or implied that the statistical method used was novel or radical, in fact the evidence showed

that it was a standard method, widely used in the industry for other purposes (Tr. 1649). Mr. Komanoff testified,

> . . . The method . . . is the most conservative, traditional and commonplace method used for analyzing empirical data. It is used by all of these parties that you and I have both discussed here. It's used throughout the Federal Government. It's used throughout the electric utility industry to do load forecasting. It's used by the technical and policy communities par excellence. What these people had not done, was to apply this standard tool to measuring the current level of costs and the rates of past and current increases in the costs of nuclear plants. And I believe that it would have been logical, professional and appropriate for them to have done so at that time.

(Tr. 1646-7).

NOPSI's witness Mr. McWhinney conceded both the method's use elsewhere in the industry (Tr. 1775) and that the method was the *standard* technique for determining trends.

Q. The method itself is not radically different. It's an acceptable method.

A. That's correct. It is not different. It is an accepted statistical method.

Q. As a matter of fact, would it be fair to say that *the method is the standard technique for distilling trends from empirical data.*

A. *That's correct.*

(Tr. 1774; emphasis added.)

The remarkable failure of Middle South, NOPSI and "the industry" to use regression analysis and to take account of the conclusions of the works of Bupp, Mooz and

Komanoff can be explained on the basis that it was not in their interest to do so, as reflected in the following examination of Mr. McWhinney:

Q. The technique was new, regression analysis was new, that's your testimony?

A. No. The answer is regression analysis was not new.

Q. The use of regression analysis to evaluate trends in nuclear plant costs was, as far as you knew, new as of about 1978.

A. That's correct.

Q. And the information being generated by the application of that technique was less favorable to nuclear plant cost predictions than that being generated by the honored technique of engineering estimation, isn't that right?

A. That's correct. Cost estimates were higher than traditional estimates.

Q. Right. And in this—and the technique, the use of regression analysis to evaluate cost trends in nuclear plants was not accepted by—or not in widespread use or accepted by the nuclear industry in the period 1978 to 1980, according to your testimony, isn't that right?

A. What is correct is that it was not in widespread use. I do not know if it was accepted or used, but I believe that it was known by people within the industry who were making decisions.

Q. Now your testimony states on Page 30, and I quote—This is referring to 1979. "In the 70's—It was widely believed that in the 1970's, that, as both the industry and the NRC

reached maturity, operating performance would improve." That's number one. Two, "regulatory turmoil would cease," that's number two. And three, "costs would level off, or even fall in real terms." Do you see that?

A. Yes.

Q. Now if you had read Mr. Mooz's report at that time and the conclusions that I read to you and that we reviewed, how would you have felt about those beliefs after having read that report?

A. They're in stark contrast.

Q. They're in stark contrast. And is their implication significant or insignificant with respect to the costs of nuclear plants?

A. They were significant, and I'm sure they received adequate attention in the minds of the decisionmakers in the industry who were concerned about what was causing these prices costs to increase.

Q. Is industry acceptance, in your view, Mr. McWhinney, a measure of—a useful measure of management prudence or imprudence?

A. The answer is no. Because, as I've testified, my evaluation of the prudence of a decision is based on either the information management had or could have had, and this information was available, and could have been used, if it were not.

Q. Could have been used, regardless of whether or not it was in widespread use?

A. That's correct.

Q. Because you're a management strategist in part, aren't you? Haven't you helped man-

agement strategize in terms of its business decisions?

A. Yes, I have.

Q. And so you would be interested . . . in the technical biases of the sponsor of particular informational views, would you not, if you were considering those in advising management?

A. Yes sir, I would.

Q. And these views were not acceptable, not favorable to the nuclear industry, were they?

A. Whose views are we talking about?

Q. Excuse me, the views that were resulting from Mr. Komanoff's analysis and Mr. Mooz's analysis were very unfavorable to the nuclear industry, weren't they?

A. I wouldn't categorize them as unfavorable. They were different. They had higher cost estimates than the output analysis.

Q. They had higher cost estimates, and cost was a very important factor, was it not, in determining what kind of plant was to be built with respect to the generation of electrical energy?

A. Yes. I've said the least cost option is the criteria that ought to be used in evaluating a decision in the industry.

(Tr. 1836-40.)

Thus NOPSI's position that Mr. Komanoff's conclusions should be rejected because they "differed radically" from the "prevailing view" in the industry in 1979 (NOPSI Br. at 43, 48-49) would require our giving credit now, to a position that deserved no credit then. There was clear

evidence that the "prevailing view" was manifestly inconsistent with empirical results and data then available to NOPSI and to the "industry."

That NOPSI (and as far as is known, MSE) failed to inform themselves of and use a standard analytical technique to evaluate the probable cost of Grand Gulf stands in such stark contrast to practices in other areas that it suggests more than inadvertent avoidance. For example, NOPSI's witness, Mr. Trumps, testified as follows:

Q. Well, as part of your job, do you, with respect to forecasting, do you investigate the or appraise the validity of the techniques used for forecasting?

A. Yes.

Q. Do you concern yourself with proposed new techniques for forecasting to see whether or not you can integrate them in your operation?

A. Yes.

Q. Do you make people responsible for making sure that they are aware of current techniques for load forecasting?

A. Yes. . . .

(Tr. 1030-1032.)

In contrast, despite the fact that regression analysis was the standard technique for distilling trends from statistical data, and despite the public dissemination of information regarding its application to nuclear plant costs, NOPSI and the "system" claim to have been wholly ignorant of it.

5. NOPSI's Failure to Deal With the Impact of the Three Mile Island Incident

It is important to understand that, even before the incident at Three Mile Island, there were major trends re-

lated to nuclear plant safety issues that would continue to increase Grand Gulf costs. Four principal sources of impending and future safety-related changes, and thus higher costs, were apparent in early 1979:

> (1) Recent nuclear regulatory requirements had been issued that had not been imposed upon completed plants. These would be imposed on plants under construction. Even plants completed in the late 1970's did not reflect regulatory requirements then in effect, because the NRC often exempted plants under construction. This was particularly true of NRC requirements concerning manufacturing, testing and performance criteria for structural materials and basic components. The codes and standards for these were in a state of almost continual revision during the 1970's.
>
> (2) New regulations could be expected because of adverse operating experiences at existing nuclear plants. Development of remedial regulatory requirements lagged considerably behind problems and accidents occurring at operating plants. For example, new rules arising from the 1975 fire at the Browns Ferry reactor were still being drafted in 1979. NRC regulations in early 1979 probably reflected operating experience accumulated through 1976 and 1977.[65]
>
> (3) It was likely that there would be future adverse experiences, based on (a) the increasing population of plants and (b) the increasing rate of detection of safety risks. This was evidenced by a far larger number of safety-related bulletins issued by the NRC during the 1976-79 period than in the early 1970's.

[65] To illustrate the magnitude of the revisions involved, it appears that the NRC had issued 143 Power Reactor Regulatory guides through 1978. Twenty-six of these were being reviewed as of March 1979, and another 25 new guides were under development. Virtually all portended higher costs for new plants like Grand Gulf.

> (4) A growing list of "unresolved safety issues" portended high costs. These were matters disclosed during individual licensing reviews for nuclear plants, which were held for resolution on a general basis. In early 1979, there were 34 items of potentially major safety significance outstanding. Lists of these issues were available to the public. Many of the issues related to plants such as Grand Gulf. (CNO Exh. 38 at 50-57.)

As previously indicated, the industry recognized changing construction and safety regulations as the principal factor in nuclear plant cost increases. (*Id.* at 59.) The factors listed above would have indicated, in 1979, that the costs of Grand Gulf would have been approximately 40% higher than a comparable nuclear plant completed at the end of 1978. (*Id.* at 60.)

On March 28, 1979 an accident occurred at Unit II of the Three Mile Island nuclear power plant south of Harrisburg, Pennsylvania. Within two weeks, the President appointed a "President's Commission on the Accident at Three Mile Island," (Tr. 1272) to investigate what was characterized as "the worst accident in the history of commercial nuclear power generation."[66] The accident focused national press attention on safety issues. As the Commission noted,

> After many years of operation of nuclear power plants . . . the belief that nuclear power plants are sufficiently safe grew into a conviction. One must recognize this to understand why many key steps that could have prevented the accident at Three Mile Island were not taken. The Commission is convinced that this attitude must be changed to one that says nuclear power is by its

[66] Report of The President's Commission on The Accident at Three Mile Island, Oct. 1979, p. 1. (hereinafter "TMI Report").

> very nature potentially dangerous, and, therefore, one must continually question whether the safeguards already in place are sufficient to prevent major accidents. A comprehensive system is required in which equipment and human beings are treated with equal importance.

As a result, major changes were recommended in the operations and organization of the NRC. Its Chairman, Mr. Hendrie, who testified in this case, was demoted. (Tr. 1287.) The incident had a profound impact on the licensing, construction time and regulatory scheme—and thus on the costs of nuclear plants. As Mr. Hendrie testified, the Three Mile Island incident, "came to dominate the thoughts in nuclear regulation for balance of that year and during the time since. . . ." (Tr. 1277).

In the months following, there was substantial, well-publicized appreciation that TMI would have a profound impact on nuclear plant construction and costs. The reasons were summarized by Mr. Komanoff as follows:

(1) The Three Mile Island incident undermined the credibility of both nuclear plant developers and regulators. It involved a degree of core damage that had previously been rejected by industry experts as impossible and which was thus placed outside the "design basis" used to set the required strength of reactor containments and the systems designed to mitigate accidents.

(2) The accident underscored the ineffectiveness of NRC regulation and industry self-regulation when it was revealed that precursor accidents elsewhere[67] had not led to

[67] The Commission notes, for example, that a related accident had previously occurred at the Davis-Besse plant and was investigated by both the NRC and the reactor manufacturer. Despite warnings by the manufacturer's engineer, no information calling attention to the need for corrective actions in similar circumstances was provided to utilities prior to the Three Mile Island accident. (TMI Report at 10, 29.)

remedial steps. In addition, it exposed the practice of "grandfathering" plants, by which new safety regulations were not applied to existing plants.

(3) Because the damage at Three Mile Island and much of the actual sequence of events during the accident extended beyond the "design envelope" assumed in safety analyses, the NRC was forced to extend the spectrum of design base accidents used for safety assessments. Particular attention was focused on core-damage accidents, and the plant systems designed to ensure that plants could deal with major core damage.

(4) The NRC was forced to abandon its "single-failure" approach to accidents and to consider what would happen if two systems or components failed independently of each other.[68] (CNO Exh. 38 at 62-64.)

The TMI Report, released October 1979, continued "serious criticism" of the NRC (Tr. 1294). Mr. Hendrie affirmed that Three Mile Island precipitated a "wide-ranging review" of the whole structure of nuclear regulation, that such review was foreseeable in 1979, and that it had the potential to affect the costs and construction of Grand Gulf. (Tr. 1342-43.) This perception of the potential impact of Three Mile Island was evident as early as May 1979 and certainly no later than the release of the TMI Report in October 1979. (CNO Exh. 38 at 66-67). In July 1979, for example, Mr. Komanoff testified before the House Interior Committee that estimates of the increased capital costs of nuclear plants attributable to TMI were "absolutely open-ended." (Tr. 1663.)

The attitude of NOPSI's management toward the Three Mile Island incident is one that approaches determined denial. NOPSI's management witnesses seemed programmed to ignore TMI entirely. In testifying about the "very dynamic time" (CNO Exh. 60 at 29) and "dynamic

[68] See TMI Report, p. 52.

changes" occurring in 1979 (*Id.* at 76), Mr. Hurstell, despite *several* opportunities to do so, failed to mention either the greatly increased costs of Grand Gulf or the Three Mile Island incident. (*Id.* at 77-81.) After some prodding, Mr. Hurstell finally testified that "I guess that's correct that [TMI] was a factor at that time". (*Id.* at 81.)

The factors that Mr. Hurstell did mention in his prehearing deposition were the price of oil and gas, the Iranian situation (bearing on the availability of oil), NOPSI's lack of a firm fuel supply for 1100 MW of generation, the Fuel Use Act curtailing use of gas and oil as boiler fuel for generation, and the United Gas curtailments of natural gas to NOPSI, but *not* Grand Gulf costs and *not* Three Mile Island. (*Id.* 77-78). The factors mentioned by Mr. Hurstell, as has been noted, were neutral as between the choice of coal or nuclear fired power (Tr. 677)—which should have been a principal matter under consideration by NOPSI at that time, had it acted prudently. Months later, in his testimony at the hearing, Mr. Hurstell added, as a "concern" in 1979, the Clean Air Act—apparently to buttress NOPSI's position here that there were also concerns over increased costs of coal fired generation based on antipollution regulations. (Tr. 663.) But again he failed to mention the Three Mile Island incident. (Tr. 665.)

When Mr. Hurstell was asked whether he thought it might have been "a little risky" for NOPSI to "load up" on a share of an incomplete nuclear plant (a fixed share of 335 MW from Grand Gulf I and 335 MW from Grand Gulf II, Tr. 677) just after the Three Mile Island incident, the following colloquy ensued:

> Q. Now, again, do you think that having NOPSI load up on incomplete nuclear plants after Three Mile Island was a little risky?
>
> A. No. Our studies at that time indicated that our customers would benefit to the tune of about 2.3 billion dollars over a 12-year period

> of time and it was to their financial benefit for us to do that.
>
> Q. And we're going to come to that in a moment, but just for now, that 2.3 billion dollar estimate was not done until 1981, isn't that correct?
>
> A. That's correct. But 1981 was 1.8 over a shorter period of time.
>
> Q. That's fine, but the number you just mentioned was not until 1981?
>
> A. All right. I'll mention the one in 1980, 1.8 billion in a nine-year period of time.
>
> Q. And that number—and I said we'll come to that in more detail later, but for the record now, that number was calculated based upon your projections of the completed cost of Grand Gulf at that time?
>
> A. Not my projection, it was Middle South Energy's projection.
>
> Q. So you just took their projection and worked it out?
>
> A. I had to do that.

(Tr. 682-683.)

Thus, Mr. Hurstell's attempted justification of alleged savings (embodied in MLH-12A and 12B) was simply a spreadsheet extrapolation of numbers supplied by MSE (Tr. 683). Mr. Hurstell had no idea what assumptions had been used in the MSE figures for Grand Gulf, nor whether an adjustment for the impact of Three Mile Island was reflected in the figures. (Tr. 709; CNO Exh. 29 at 164.)

Mr. Hurstell testified not only that there were no meetings at NOPSI with regard to the impact of Three Mile

Island on Grand Gulf costs because of alleged reliance on MSE, but also that he was not concerned about the Three Mile Island incident because no one "knew" what the impact would be:

> Q. All right. Now, were there any meetings at NOPSI with regard to Three Mile Island and the effect it might have on NOPSI's Grand Gulf costs in, say, the period of ten or eleven months following Three Mile Island?
>
> A. No, and for a very good reason.
>
> Q. I don't know if there can be any good reason but what is the reason you would offer?
>
> A. The reason is that we relied upon the expertise that was assigned to overlook the Grand Gulf project and that was MP&L.
>
> Q. Weren't you concerned yourself? You were a major buyer; you're now thinking about a commitment of 670 megawatts and there's Three Mile Island; you don't hold a meeting?
>
> A. Because Three Mile Island we didn't know the impact at all. I know it was a significant impact that happened, but what was going to be the impact on the nuclear energy industry nobody knew in 1980, I'll say.
>
> Q. No one knew for sure, and didn't that bother you more than anything, there was a significant event that had not been quantified in a way you knew about, yet you took a risk on an incomplete nuclear plant?
>
> A. I can tell you my major concern at that time.
>
> Q. No. Were you concerned about that?
>
> A. I'll say no, I was not concerned. . . .

(Tr. 684-686.)

The result of NOPSI's inattention to unfolding events was that it was left ignorant of what prudent management should have known, and others did know, about the potential impact of Three Mile Island. Mr. Hurstell testified,

> Q. I think that at the time you had no—your testimony is that in the year 1979 you had no appreciation that Three Mile Island might result in substantially increased costs with respect to Grand Gulf?
>
> A. I had no idea, no, sir.

(Tr. 668.)

In rebuttal, NOPSI charged that Mr. Komanoff's (and others') views on the underlying nuclear plant cost trends, and the related impact of Three Mile Island, were outweighed by other authorities. Thus, Mr. Hurstell stated in prepared testimony as follows:

> "Speaking from NOPSI's perspective in 1980 Mr. Komanoff's views were overwhelmed by the abundance and quality of analyses provided by other credible sources from industry and the federal government."

(NOPSI Exh. 37 at 32.)

As a basis for this assertion, Mr. Hurstell referred to several analyses attached as exhibits to his prepared testimony. (*Id.* at 31-32.) At the hearing, he testified that all the analyses were examined in anticipation of NOPSI's making its January 1980 commitment for a large fixed share of Grand Gulf. (Tr. 757.) On cross examination, Mr. Hurstell's testimony as to reliance upon, and use of, the cited materials turned out to be wholly unfounded. Specifically: The Gibbs and Hill Report (NOPSI Exh. 27, MLH-27) was first published on January 28, 1980 and could not have been relied upon by NOPSI (Tr. 758). Moreover, lan-

guage, said by Mr. Hurstell in his prepared testimony to be from the report and to show a continuing advantage of nuclear over coal (*viz*, "nuclear continues to show a significant advantage over coal," *Id.* at 31), was not in the report at all, but in a transmittal letter (Tr. 759), and referred to inflation, *not* the impact of Three Mile Island. (Tr. 760-1, 763.) The report itself had raised an open-ended concern about the cost impact of Three Mile Island (Tr. 764-5), just as Mr. Komanoff had (Tr. 1541), as Mr. Hurstell so conceded under cross-examination:

> Q. . . . [W]ouldn't you agree that the report is indicating that there was a problem -with Three Mile Island which will, in fact, have cost consequences and they are at the present undeterminable?
>
> A. Yes.
>
> Q. Open-ended?
>
> A. I believe at this time there are other entities such as the N.R.C. which are estimating a, $25,000,000 plant estimate at that time.
>
> Q. We will take these reports one by one, but, you see, if you talk about another report while I am asking you about this report, that's sort of an escape hatch, and I can't get you to talk about this report. So I need you to focus on this one. If you looked at it at the time as a prudent manager, that is the conclusion you would have come to, isn't it?
>
> A. That's correct.

(Tr. 769.)

Another report, the *National Energy Outlook* (NOPSI Exh. 37, MLH-26) was first offered as one that NOPSI relied upon in 1979 (Tr. 771), but it was a *1976* report, and Mr. Hurstell testified on cross examination that NOPSI

did not rely upon it in making its Grand Gulf commitment in January 1980. (Tr. 772.) Another, the *Environmental Report* (NOPSI Exh. 37, MLH-23), was prepared in March '79 by MP&L and did not in fact purport to reflect any of the costs of the Three Mile Island incident. (Tr. 775.) Moreover, Mr. Hurstell was unaware of the sources of information used by MP&L in producing the report. (Tr. 776.)

When the testimony turned to other reports—such as copies of two speeches by L.F.C. Reichele, one entitled "*The Economics of Nuclear vs Coal*," October 30, 1979 (MLH Exh. 28) and another of the same date by the entitled "The Urgent Need for More Base Load Electric Generating Capacity" (MLH Exh. 29A)—it turned out that Mr. Hurstell could not say that anyone at NOPSI reviewed the reports. More troubling is that the reports were not even found in NOPSI's files. Rather, they had been taken from LP&L files by an employee there at Mr. Hurstell's request in order to draft prepared testimony in this proceeding. (Tr. 781-786.)

The truth appears to be that in 1980, NOPSI's management never even considered Komanoff's work or that of Bupp and Mooz (Tr. 721), and it likely never read any of the reports which it filed as part of NOPSI's prepared testimony. Furthermore, Mr. Hurstell's attempt to testify as to NOPSI's reliance upon unspecified other reports was properly made subject to a motion to strike (Tr. 885) and is of "little value," as the Hearing Examiner correctly concluded. (Tr. 887.)

Turning to the issue of the potential quantitative impact of Three Mile Island, we find reasonable and well-founded Mr. Komanoff's contention that NOPSI should have estimated that the regulatory impact of Three Mile Island would add about 25 percent to the capital costs of Grand Gulf. Such estimate was based on a particularized analysis of the impact of Three Mile Island by Komanoff, previously

discussed. (CNO Exh. 38 at 61-68.) It was offered as a "reasonable, probably conservative figure." (*Id.* at 68.)

To be precise as to the substance of Mr. Komanoff's position, he testified that NOPSI's management should have used a range of figures in order to show both the high and low ends of possible exposure. (Tr. 1628-29). He believed that, from the perspective of 1979, about 15 percent was the low end, and the high was "absolutely open ended."

In rebuttal, NOPSI's witness, Dr. Perl, asserted that Mr. Komanoff's 25 percent figure was excessive (when added to the 40 percent increase estimated to account for regulatory changes already unfolding and previously described.) However, since the real capital costs of nuclear plants had more than *doubled* in just the half dozen years since the early 1970's, a 25 percent estimate appears reasonable.[69] There was a clear prospect that Three Mile Island would give rise to extraordinary demand for new actions to increase nuclear plant safety. (CNO Exh. 38 at 69.)

NOPSI also offered the testimony of Mr. Hendrie, former NRC Chairman. His testimony that the NRC staff had, in 1979, estimated the TMI regulatory impact at $20-50 million per unit, cannot be given great weight because of the witness' own concessions as to the low quality and origin of the estimate, which was not based on any study, and was "quick and dirty." He further testified that the NRC cost estimates were "uniformly" viewed by industry as underestimations. He also noted that the NRC did not

[69] Indeed, Mr. Komanoff's estimate as of 1979, based on the 25 percent figure, was that Grand Gulf would cost $1475/KW, and turned out to be low. The actual cost at completion was substantially greater—$2253/KW (both figures in 1984 dollars without AFUDC). (CNO Exh. 38 at 69.) Actual results in 1984 are not a proper basis for evaluating a utility's prudence in 1979, and we do not rely upon them for that purpose.

have statutory authority to consider cost factors. (Tr. 1296-1299.)

Finally, NOPSI's assertion that the 25 percent Three Mile Island factor proposed by Mr. Komanoff should be discounted because Mr. Komanoff used a 17 percent factor in his book *PPCE* is not well-founded. The book characterizes the 17 percent figure as "conservative" (CNO 39, p. 283), whereas choice of a conservative figure by NOPSI in assessing Grand Gulf costs was not appropriate in the circumstances. In particular, Mr. Komanoff testified that prudent management should have considered a *range* of estimates. It is clear that if NOPSI had done so, it would have appreciated the seriousness of its possible exposure, and protective action would have been indicated. Moreover, use of the 17 percent figure would not greatly reduce the cost/benefit ratio of Grand Gulf to coal, *i.e.*, it would be reduced from 1.235 to 1.195.

In summary, NOPSI's assumption of a large fixed share of Grand Gulf reflects, at best, a corporate atmosphere of indifference; and at worst, an effort to postpone public awareness of NOPSI's serious predicament. NOPSI's witness, Mr. Louiselle, testified in a related proceeding that the allocation took place "after everyone realized what the cost of the unit was going to be." (CNO Exh. 33 at 856). AP&L was allowed by the "system" to withdraw from Grand Gulf participation on the basis of decreasing load growth and "political and regulatory pressures." (Tr. 528.) A group of municipal electrical electric companies, organized as the Municipal Electric Association of Mississippi ("MEAM"), dropped out of the Grand Gulf project sometime in 1980, but NOPSI's management, in particular, seemed to have little knowledge of why it did so. (CNO Exh. 29 at 127-138.) NOPSI, on the other hand, subscribed for a disproportionately large 670 MW share of Grand Gulf I and II, and had no plans for the purchase of coal-fired power, except for 80 MW almost a decade later. It remained unaware of important analyses of nuclear power

costs, dismissed the importance of the Three Mile Island incident and failed to explore other options.

6. NOPSI Should Have Realized, in 1979, that the Cost of Grand Gulf Power Would Be Uneconomic.

Mr. Komanoff testified that, if NOPSI had employed a standard method of statistical analysis and had taken the impact of Three Mile Island into consideration, it would have determined in mid-1979 that the lifetime cost of Grand Gulf was likely to be about 20 percent higher than that of contemporaneously available coal-fired power. NOPSI's acceptance of a 29.8 percent share of Grand Gulf I (or 335 MW) "consigned the utility to an excess lifetime cost of approximately $320 million compared to available coal capacity, as costs could and should have been seen in 1979 during its negotiations leading to the 1980 Reallocation Agreement." (CNO Exh. 38 at 9.) Details of the calculation are set forth in Exhibits CK-2 *et seq.* of the Komanoff testimony. (*Id.*)

As it turned out, of course, the disparity between the costs of Grand Gulf and coal-fired power was much larger even than projected by Komanoff and has resulted in lifetime costs, by today's estimates, over *triple* those of coal-fired power. (*Id.* at 11.)

NOPSI's attempt here to undercut Mr. Komanoff's conclusions was not well-founded. NOPSI's expert witness suggested that the Council should make two major changes in the assumptions used by Mr. Komanoff (Tr. 1716).

a. Capital Additions.

The first change would involve deleting Mr. Komanoff's estimate of the cost of capital additions to both coal and nuclear plants. (NOPSI Exh. 53 at 41.) A deletion of capital additions would result in subtracting $500.8 million from the life cycle cost estimate of Grand Gulf I, but only $94.7 million for the coal alternative. NOPSI argued that costs for capital additions were not recognized as significant factors until after 1979. It pointed to the fact that the term "capital additions" was not mentioned in Mr. Komanoff's book *PPCE* or in certain testimony that he gave in 1981. (*Id.* at 39). However, capital additions were in fact treated in *PPCE* under the name "interim capital replacements." (Tr. 1550-52.) While NOPSI pointed out that in *PPCE*, regression analysis had not been used to project the costs of interim capital replacements, Mr. Komanoff answered satisfactorily that the *PPCE's* focus was almost entirely on *capital* costs,[70] and other costs were treated only in a summary fashion. (Tr. 1625-26.) In circumstances where NOPSI needed to evaluate, in a prudent manner, its Grand Gulf exposure, there would have been no reason for it not to have used standard statistical analysis for all its relevant costs. NOPSI certainly had the financial resources to engage such a study. (Compare Tr. 1625.)

b. Operation and Maintenance Costs.

The second change suggested by NOPSI was that operation and maintenance ("O&M") costs should be equalized for coal and nuclear, because, it says, such was done by Mr. Komanoff in *PPCE*. However, the analysis there involved a coal plant with a "scrubber," not comparable to ISES, which was the basis for alternate coal costs here. (Tr. 1635.) Equally important, Mr. Komanoff noted that in *PPCE* the O&M costs were treated in the same manner as capital additions—*i.e.*, only summarily. (Tr. 1635-39.) (Moreover, the ratio of O&M costs for a nuclear to a coal plant without scrubbers was stated in *PPCE* at 2.2-1, not

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[70] This was an important point. *PPCE* is subtitled "Nuclear and Coal Capital Costs, Regulation and Economics." At the outset it states its objective as follows: "The book investigates nuclear and coal *capital* (construction) costs. . . ." (CNO Ex. 39 at 1; emphasis added.) The first ten of twelve chapters deal wholly with capital costs. Chapter 11, to which NOPSI refers, is entitled "Non-Capital Cost Factors" and contains only summary treatment of a number of other factors.

the 1-1 ratio claimed by NOPSI.) (Tr. 1638; CNO Exh. 39.)

NOPSI's witness Dr. Louis Perl argued that Mr. Komanoff incorrectly evaluated historic trends in computing nuclear O&M costs by relating such costs to unit vintage and age, instead of to time. (NOPSI Exh. 46 at 3, 10.) He asserted that Mr. Komanoff's approach assumed that the historic effect of regulation had been to drive up the costs for only new nuclear units, while it has in fact increased costs over time for both old and new units. Even if we accepted the premise that units of all ages were affected, it does not follow that a correlation to vintage implies an impact exclusively on new units, but rather that they are affected more, which appears sensible. Moreover, Dr. Perl's calculations did not carry forward the trend to project future O&M costs, presumably on the assumption that (despite persistent growth in O&M costs in the 1970's and the impact of Three Mile Island) such trends would not continue, which seems unreasonable. It is therefore difficult to assign great weight to Dr. Perl's position. In addition, Dr. Perl's presentation on this point was, by his own concession, not fully developed. (Tr. 1372-1376).

c. Pricing Coal-Fired Alternatives.

Apart from proposing the two major charges noted above, NOPSI also accused Mr. Komanoff of using impermissible "hindsight" because, in attempting to determine the costs of a coal-fired alternative in 1979, Mr. Komanoff used 1983-84 costs for AP&L's ISES coal-fired plant. (Tr. 1509-1512.) To the contrary, Mr. Komanoff used data as it existed in 1979-80 and took the approach noted with respect to ISES only as a direct result of NOPSI's blanket refusal here to provide data relating to other companies in the Middle South system. Because of this, Mr. Komanoff was obliged to reconstruct this data as it would have existed in 1979, taking note that AP&L was then engaged in building two identical coal-fired units—ISES

and White Bluff, and that in 1979 White Bluff was almost complete. (Tr. 1515.) However, he did so in ways that involved conservatisms not favorable to his position (Tr. 1513-15), and this resulted in computations *more* favorable to NOPSI than would have resulted from using cost estimates actually available in 1979. (Tr. 1679-80, 1515-6.)

In this connection, Dr. Perl testified that Mr. Komanoff's cost projections for a coal-fired alternative were understated because he used adjusted White Bluff fuel costs as a surrogate for those of ISES, while in fact, as stated in Mr. Trumps rebuttal testimony, the costs of ISES were about 15% higher than those of White Bluff. (NOPSI Exh. 46 at 11.) However, Dr. Perl apparently failed to note that Mr. Komanoff had used a *higher* fuel cost escalation factor than that set forth in Mr. Trumps' testimony—the result being that if Mr. Trumps' base fuel cost and escalation rate had been substituted for those of Mr. Komanoff, the net effect would have been to *reduce* the fuel cost of the coal-fired alternative, which would work to NOPSI's disadvantage here. (Tr. 1525-26.)

Similarly, in reconstructing the capital costs for ISES, Mr. Komanoff used the actual ISES costs from 1983-4, which in real dollars were six percent *more* that White Bluff. His calculations "thus took on that six percent burden, which I am not sure that I would have done in 1979, . . . to be conservative." (Tr. 1516.) In addition, while Dr. Perl argued that Mr. Komanoff should have used a statistical method for the projection of ISES costs (NOPSI Exh. 46 at 11), this would seem to ignore the fact that ISES and White Bluff were identical, and that the costs of White Bluff were substantially established in 1979—thus presenting a more reliable basis for calculation.

d. NOPSI's Selective Use of Cost Assumptions.

A large part of NOPSI's cross examination of Mr. Komanoff involved requiring him to do recalculations based upon assumptions or factors favorable to NOPSI, but pro-

hibiting him from taking into account any countervailing considerations. Mr. Komanoff was, for example, directed

> (a) to accept NOPSI's (actually, AP&L's) projection of White Bluff fuel costs, but to use Mr. Komanoff's own assumed escalation rates for such costs, rather than those of NOPSI (Tr. 1529)
>
> (b) to accept the maximum of ranges when favorable to NOPSI—such as a 25 percent increase in coal O&M costs (Tr. 1668); and the minimum when favorable to NOPSI—such as the nominal amounts contained in *PPCE* for "interim replacements." (NOPSI Brief pp. 54-66.); and
>
> (c) to alter the values in Mr. Komanoff's regression equation so as to adjust certain figures when favorable to NOPSI, but not to do so if unfavorable to NOPSI. (Tr. 1698.)

This approach to the calculations was properly dismissed by Mr. Komanoff as follows:

> Q. . . . Now, I want to ask you, Mr. Komanoff, I want you to assume that an estimator in 1979 had made the calculations of the cost of Grand Gulf and the counterpart coal costs that were the subject of these calculations, just as Mr. Schultz directed you to do today, would you have regarded that as a professional product?
>
> A. No, I would not. Any analysis or any conclusions in which an analyst systematically employed assumptions at one end of a range would obviously not be a professional work product.
>
> Q. And adding to that the fact that you were asked . . . to cap certain factors and not cap other factors, would you have regarded that

> in gross as an unprofessional product if you had been the recipient?
>
> A. Yes, I would have.

(Tr. 1673-74.) In our view, management's knowing use of such an analysis to reach decisions on important matters would have been imprudent.

e. Role of Grand Gulf II.

NOPSI's witness, Dr. Perl, also argued that Mr. Komanoff's calculations incorrectly estimated the cost of Grand Gulf I because they assumed that it would be a single-unit project. He asserted that the cancellation of Grand Gulf II was not contemplated in 1979, and that MSU and NOPSI should not be held to have anticipated that it would not be possible to complete the Grand Gulf II unit. (NOPSI Exh. 46 at 3, 9-10). "It was only much later," Dr. Perl stated, "that increases in capital costs and interest rates made it necessary to defer Unit 2." (*Id.* at 10.) However, in 1979 construction on Grand Gulf II was minimal. If we accept, as we do, that a prudent analysis conducted in 1979 would have shown that Grand Gulf I was likely to be uneconomic, the cost trends would have been even more corrosive with respect to Grand Gulf II.

It is difficult to see how the completion of Grand Gulf II could have been deemed likely to anyone but its most dogged proponents. At the very least, NOPSI should have assumed the potential cancellation of Grand Gulf II as part of the range of prospects comprising its costs in 1979. There is no evidence that it did so.

7. NOPSI Should Have Sought to Reduce its Grand Gulf Risk.

We must start with the overriding observation that NOPSI's managers were clearly not, in 1979-1980, committed to take actions that would protect NOPSI's interest. Rather, NOPSI's management was apparently caught up

in implementing the overall strategy of spreading the burden of Grand Gulf to areas where regulatory and political resistance was lowest, while publicly trying to pass off NOPSI's Grand Gulf commitment as a great "benefit." NOPSI acceded to AP&L's escaping its commitment entirely, while NOPSI committed itself to 29.8 percent of Grand Gulf—an amount that one of its own expert witnesses, Mr. Louiselle, had previously characterized as imprudent. (CNO Exh. 33 at 853). Mr. Louiselle testified in a related proceeding that the "reallocation took place after everyone realized what the cost of the unit was going to be." (*Id.* at 856.) Yet, as previously indicated, in September 1980, NOPSI's officers were before the Council, seeking an automatic Grand Gulf cost pass-through by means of a capability adjustment clause, and testified that this would result in great benefits for ratepayers in New Orleans. (CNO Exh. 29 at 62-63.)

NOPSI made no Grand Gulf allocation proposal of its own, and NOPSI's president made no effort to resist the excessive Grand Gulf allocation and was even unsure of NOPSI's rights within the system to refuse to take so large an allocation. (Tr. 464-65.)

It is important to note that the FERC subsequently reduced NOPSI's allocation to 17 percent. This action mitigates the *results* of NOPSI's management imprudence because it curtailed NOPSI exposure by 12.8 percent of Grand Gulf. The FERC's action, however, in no way undercuts the negative judgment to be reached here on the prudence of NOPSI's management. Rather, it reinforces it.

Acting prudently, NOPSI should have reduced the risk of its Grand Gulf obligation by selling off as much of its Grand Gulf power as possible, considering all the circumstances, and by contracting for coal-fired power to displace its oil and gas-fired generation. (CNO Exh. 38 at 10.) Whether or not NOPSI had or would get an "involuntary"

allocation from the "system" or the FERC, it was *not* "involuntary" for NOPSI's management to fail to explore a possible resale of part or all of its Grand Gulf power in order to reduce its exposure to the potential adverse economic impact of that nuclear project. This is not a difficult concept. Any prudent businessman, anticipating that his commitment to an obligation may prove excessive or uneconomic—say, a commitment to office space or raw materials—would take steps to "hedge" against or lessen the risks of that commitment through, say, subletting, or contracts for the future disposition of parts of the materials.

NOPSI's president twice stated in his testimony before the Council in 1980 that NOPSI could sell its Grand Gulf power to other utilities, and that it would do so if the Council so desired. However, NOPSI's witnesses here sought retroactively to raise barriers and hindrances to such a sale by NOPSI. Such testimony is of little weight in view of the history of off-system sales on the system, and Mr. Cain's contemporaneous representations to the Council. There had previously been off-system sales of participation in generating plants owned by Middle South operating companies. (CNO Exh. 29 at 32.) Moreover, off-system sales of ISES and White Bluff participation were made by AP&L (NOPSI Exh. 40 at 6-7). While Mr. Trumps sought to distinguish these on the basis that the buyers were established "wholesale customers" of AP&L, the very fact that AP&L had off-system wholesale customers illustrates instead the ability of a Middle South operating company to deal off-system. Mr. Trumps testified as follows:

> Q. . . . The entities that you referred to were entities to which AP&L sold at wholesale? Isn't that right?
>
> A. Yes. They are approved rate schedules.
>
> Q. Were they on system companies at the time that they were wholesale customers? Were they members of the Middle South System at

the time they were wholesale customers of AP&L?

A. No, they were not.

• • •

Q. So there had been transactions with entities no part of the Middle South System which involved those companies, whatever the legal form of the transaction, buying power that was generated by entities on the system, whether or not by a purchase or as a participation in a plant, isn't that right?

A. That is correct. You can go on—not only Arkansas but Louisiana Power and Light and Mississippi Power and Light had wholesale customers.

(Tr. 1053-7.) NOPSI's attempt at the hearing to revive this distinction was not persuasive. (Tr. 1072-3.)

Mr. Trumps also testified that a change made in the 1982 System Agreement reflected the existing practice of off-system sales.

Q. You stated in the second full paragraph quote, "The new service schedule in the 1982 System Agreement also established the principle that if a company has excess generating capacity, the other companies have the right of first refusal." Do you see that?

A. Yes.

Q. Why was it appropriate that that rule be established?

A. Why was it appropriate it be established in the 1982 System Agreement?

• • •

A. Okay. This particular principle is in there

which *would obviously allow an individual operating company to make an off system sale if the other companies within the Middle South System do not choose to acquire it for themselves.*

Q. That is the way I read it.

(Tr. 1048-9; emphasis added.)

Several NOPSI witnesses sought to raise other entanglements to an off system sale, arguing *e.g.*, that if NOPSI had sold a portion of its Grand Gulf entitlement off-system and had sought to replace it with coal-fired generation, it would have had to buy 130% of the displaced power in the form of coal-fired generation because of reserve requirements. (Tr. 1236-7.)

At one point in the hearings, until objection was made, counsel for NOPSI and one of its expert witnesses apparently coached Mr. Trumps on answers to questions so as to make it appear that NOPSI was "trapped" by the system—*i.e.*, that it could not avoid additional allocations of Grand Gulf to make up for any amount which it sold off-system (1078-1079). However, Mr. Trumps ultimately testified that there were procedures that would have allowed NOPSI to sell off-system without increasing its Grand Gulf allocation. (Tr. 1080-1085.)

It should be noted that a sale off-system by NOPSI of part of its Grand Gulf power entitlement would not have undercut any financial obligation—established by the system or by the FERC—that NOPSI might have had with respect to Grand Gulf I. NOPSI, for example, could have remained financially responsible for its portion of Grand Gulf. A part thereof would have been sold to and paid for by one or more customers secured by NOPSI. The payments received would have been used by NOPSI to discharge its obligation to pay wholesale costs for its portion of Grand Gulf.

As indicated, NOPSI's president specifically testified before the Council in September 1980 that NOPSI could sell its Grand Gulf power off-system:

> "NOPSI has the option of selling capacity and marketing it which we think will be a very attractive commodity to other electric utilities who will view this as very cheap, reliable power for the future." (Tr. 792; Transcript of Sept. 17, 1980 Hearing at 547.)

And at another point,

> "[W]e will have the option of selling the unit and our portion of it to some other buyer." (Transcript of Sept. 17, 1980 at 561.)

Mr. Hurstell also testified that NOPSI could have sold its Grand Gulf power in 1980:

> Q. Now you have also testified that Grand Gulf power was marketable in 1980, is that right?
>
> A. Yes.

(Tr. 793.)

Furthermore, in March 1982, MSS, acting as agent for each of the Middle South operating companies (except AP&L which had been relieved of its Grand Gulf share), offered "all, or any part of, the capacity and energy" from the Grand Gulf I Nuclear Unit for sale to 57 different utilities. (NOPSI Exh. 36, MLH-21.) There were no takers. By that time, however, the cost forecasts for Grand Gulf had risen so as to make the power virtually unsalable. (Tr. 795; CNO Exh. 29 at 142-149.)

Despite NOPSI's representations to the Council in 1980, NOPSI's witnesses argued that, as a matter of theory, no one would have bought any of NOPSI's Grand Gulf share in 1980 because, they said, if it were "prudent" for NOPSI to sell, it would have been "imprudent" for a buyer to

purchase. (NOPSI Exh. 34 at 9.) Mr. McWhinney referred to the proposal to sell as a "greater fool" theory. (NOPSI Exh. 53 at 43.)

This view misses the point of the testimony and the realities prevailing in 1980. NOPSI conducted no prudent, critical examination of its Grand Gulf obligations. Had it done so, it would have found plausible the prospect that Grand Gulf would result in a massive liability. At the time, however, this would have been a forecast and not a certainty, as it is now. Moreover, prudent planners would have assessed a *range* of possible results. (Tr. 1628.) Given uncertain times and the imperfect foresight that inheres in any forecast, NOPSI could well have found one or more buyers—including buyers cognizant of the risks in nuclear power cost estimates. While NOPSI, a relatively small utility, was overloaded with nuclear commitments to both Grand Gulf I and Grand Gulf II and had virtually no coal ownership, utilities elsewhere with no nuclear generation could have viewed a purchase of some portion of Grand Gulf as a means of diversification. NOPSI, having made *no* attempt to seek a buyer when it should have done so, at a time when the company was publicly touting the prospective "benefits" of Grand Gulf and its president twice assured the Council as to the availability of buyers, cannot now be heard to say that there would have been no buyers.

In light of NOPSI's representations to the Council, the Council did not conduct a further inquiry, in 1980, into NOPSI's involvement in Grand Gulf. Moreover, in 1981, the Council agreed to allow a referendum to transfer regulatory control over NOPSI to the LPSC, a move that proved to be detrimental in the proceedings before the FERC. Although the Council does not base its decision here on NOPSI's 1980 representations, NOPSI, by any fair standard, should be deemed equitably estopped to deny that it could not have sold power off-system and that the New Orleans' ratepayers now must bear the full burden of its imprudence.

The Council declined to approve the capacity adjustment clause proposed by NOPSI.

Mr. Hurstell, contrary to his prior testimony that Grand Gulf power was marketable in 1980, asserted a belief that there would have been no customers in 1980 for NOPSI's Grand Gulf power. His testimony, however, referred only to a few utilities (NOPSI Exh. 37 at 36), not the large number later solicited by MSS. Moreover, it cannot be squared with either Mr. Cain's testimony that the power could be sold; Mr. Hurstell's own testimony that the power was marketable in 1980; or the efforts made in 1982 to market the power.

Finally, the fact that NOPSI's share of Grand Gulf I was not a fixed amount (until NOPSI committed to a large share in 1980) does not excuse NOPSI's inaction. In the circumstances prevailing in 1979, NOPSI could be *sure* that it would be required to take (or would have access to) a sizeable share of Grand Gulf I, and certainly could have styled contracts giving it a right to sell a significant portion to others. Moreover, contractual clauses dealing with unexpected events would have been possible, if indeed they were necessary. Uncertainty is inherent in business decisions and did not entitle NOPSI to do nothing in the circumstances described.

8. NOPSI Failed to Explore and Take Advantage of Opportunities to Purchase Coal-Fired Capacity as an Alternative to Nuclear Power.

Because NOPSI was determined to portray Grand Gulf as a cheap source of energy, it never sought alternative sources (principally coal-fired) as part of its program to displace oil and gas. Moreover, as NOPSI confirmed in response to the Council's data request number PC-4, it never undertook any comparison of Grand Gulf costs to coal-fired alternatives. (CNO Exh. 38 at 40.)[71]

[71] Mr. Hurstell testified that a coal-fired alternative was not included in the "study" set forth in NOPSI Ex. 36, MLH-12 and 12A, because there was no coal capacity available (Tr. 691, 699), which does not appear to have been true, as indicated in the text that follows.

NOPSI assumed a passive role, and did not consider purchasing any share of White Bluff because it "was not made available to us" (Tr. 502)—although forty percent of the plant was sold to non-system companies. (NOPSI Exh. 40 at 6.) NOPSI's president claimed to have discussed an opportunity to buy participation in the ISES coal plant but did not pursue it because of NOPSI's plans for Wilton. (Tr. 503.) However, NOPSI had no concrete commitment for the Wilton coal plant at any time. Moreover, the Wilton project was, in any event, almost a decade off; NOPSI's anticipated share of the project's capacity was relatively small (80 MW); and the likelihood of NOPSI's participation in Wilton was itself rendered problematical by the looming costs of Grand Gulf.

It is highly probable that coal-fired power was available to NOPSI during relevant period. For example, MP&L apparently began consideration of purchasing participation in ISES by no later than January 1980. The matter was actively discussed and negotiated in that year, and it was completed in 1981. MP&L's purchase involved 400 MW. Total sales to others by AP&L from the 4 units comprising White Bluff and ISES amounted to 1984 MW. (CNO Exh. 38 at 36.) There is reason to assume that NOPSI would have been able to participate also, had it actively pursued the matter, instead of passively assuming that no coal-fired power was available

In addition, coal-fired power was available from the Southern Company for at least a five year period—certainly long enough to give NOPSI an opportunity to let the "dynamic time period" settle and to seek other alternatives. While Mr. Hurstell claimed that he ignored this opportunity because Southern Company's coal-fired power was not available for the life-of-the-plant, this was certainly

not a prerequisite to its being valuable. (Tr. 699-704; 911-913.) In related testimony before the LPSC, Mr. Hurstell stated that short-term purchases represented useful opportunities:

> "Question: Mr. Hurstell, you just finished telling me 20 minutes ago that one year purchase of White Bluff or two year purchase of White Bluff or three year-year purchase of White Bluff is just as good as a permanent purchase of a unit, didn't you?
>
> Answer: Yes, sir.

(*See* Tr. 702-703.)

In contrast to NOPSI, MP&L's planning department performed its own analysis of ways to displace oil and gas generation, which led to the purchase of 25 percent (400 MW) of AP&L's ISES coal plant (NOPSI Exh. 38 at 41)—even though MP&L was the Middle South system's agent for the construction of Grand Gulf.

The record here reveals a situation in which one act of imprudent management led to other acts of imprudence and missed opportunities. NOPSI's acceptance of an excessive share of Grand Gulf I, and its commitment to extolling its illusory benefits, disabled it from participation in other, more beneficial projects. Mr. Cain testified before the LPSC in 1983 in response to cross-examination by the City's attorneys, as follows:

> Q. What are the ownership percentages of that unit [ISES] sir?
>
> A. I know the Arkansas Electric Co-op owns a percentage, Arkansas Power & Light owns a percentage. Now how—I think Arkansas and Mississippi own the majority, 51% and the remainder is owned by the Arkansas Co-op.

> Q. Will you accept, subject to check, that Mississippi owns approximately 25% of the Independence Unit?
>
> A. Yes.
>
> Q. That is one example of one of the smaller operating companies on the Middle South System buying a portion of coal fired generation at the same time that it will have other nuclear fired generation, is that correct?
>
> A. That is correct. And that opportunity, likewise, would have been made available to LP&L and NOPSI, but it could not be afforded.
>
> Q. It couldn't be afforded because NOPSI and LP&L were getting such a high allocation of Grand Gulf power, is that correct?
>
> A. That may be one reason sir. It may be because we did not have the rates that gave us the financial viability at the time to make the commitment.
>
> Q. Well, if they got the same allocation of Grand Gulf power that Arkansas is getting, they certainly would have been able to afford 25% for participation in the Independence coal-fired generating station, is that not true?
>
> A. I don't know if that would be true sir.
>
> Q. What would you suppose sir in your best judgment as the Chief Executive Officer of LP&L and NOPSI?
>
> A. I would assume that it would be true, but I don't know it to be true.

(CNO Exh. 30(c) at 104.)

In summary, despite the concerns NOPSI expressed about not putting all its eggs in one basket (see *e.g.*, Tr. 851), in January 1980, many months after TMI, and in the face of rapidly escalating nuclear costs, NOPSI failed to explore alternatives, failed to diversify and—without critical examination—committed to 670 MW of two units of an unfinished nuclear plant. At that time it had an unfirm expectation of attaining only 80 MW of coal, which would come on line, if ever, about a decade later. (Tr. 679-80.)

By failing to sell its Grand Gulf power as it said it could do, and by failing to acquire a source of coal-fired capacity, NOPSI had not only exposed itself and its ratepayers to extraordinary costs, but it also had abandoned one of the claimed rationales for Grand Gulf, the need to diversify. Thus, Mr. Cain testified in 1983 before the LPSC, again in response to cross-examination by the City's attorneys, as follows:

> Q. Now, with respect to NOPSI's mix for fuel and base load generation, all of NOPSI's eggs for the present decade up until at least 1992 will be in the nuclear base load basket, is that true.
>
> A. Base load generation, yes sir.
>
> Q. And that is in one basket in fact, it's the Grand Gulf Nuclear Generating Station, is that correct?
>
> A. That's correct.
>
> Q. Now, sir one of the reasons why NOPSI was originally interested in getting involved in a fuel diversification program, was the possibility of fuel interruption for oil and gas, isn't that true?
>
> A. That's correct.

> Q. And you did not want to be stuck with one source of base load generation that would be susceptible to potential shut-down or interruptibility, is that correct?
>
> A. That's correct.
>
> Q. Now, sir if there is an interruption for any reason in the Grand Gulf Nuclear Station, what impact will that have on NOPSI's base load generation from now until 1992?
>
> A. It would be necessary to purchase replacement power from some other entity.
>
> • • •
>
> Q. So all of NOPSI's eggs in terms of base load generation are not only in one generating station, but they are in the highest incremental cost generating station in the System, is that true sir?
>
> A. One of the two highest yes sir.

(CNO Exh. 30(c) at 101, 103.)

We find that NOPSI's conduct, throughout, fell far short of prudent utility management.

VII. EVIDENCE REGARDING ECONOMIC IMPACT OF POSSIBLE REMEDIES

A. Procedural Background

At the initial prudence hearing, written testimony submitted by both NOPSI and the City dealing with the economic impact of possible imprudence remedies was admitted into the record without cross-examination, on the basis that a subsequent hearing might be held to deal with that matter in detail. On May 20, 1986, the Council advised the Hearing Examiner to convene such a hearing. We set dates for discovery and the submission of additional tes-

timony, which were later rescheduled, because of other obligations of both the Council and the participants. Our letter to the Hearing Examiner dated August 29, 1986, set final dates for submission of direct testimony by all participants on September 30, 1986, followed by rebuttal testimony on October 10, depositions thereafter and the commencement of hearings on October 21, 1986. As it turned out, NOPSI submitted no direct testimony, but rather filed "rebuttal" testimony on October 10, 1986 in response to direct testimony submitted by others.

The first hearing on the economic impact of possible remedies took place from October 21 to 24, 1986. During the course of the hearing, it became clear that the economic impact might be materially dependent upon the operation of federal tax laws. Tax reform legislation was under consideration during the summer and fall of 1986, and the Tax Reform Act of 1986 was enacted while the October 1986 hearing was in progress. NOPSI submitted an evaluation of the impact of the new tax law at the close of the October hearings (NOPSI Exhs. 75 and 76), but it has since stated that this was preliminary and should not be relied upon. However, it was apparent that, because of the new tax legislation, reconsideration of the testimony was necessary.

By letter dated November 5, 1986, the Council established a schedule for testimony, discovery and hearings limited to the impact of the Tax Reform Act of 1986. At NOPSI's request the schedule was extended. By letter dated December 2, 1986, the Council set a new schedule which called for a hearing to be held on February 24, 1987. It was held and concluded on that date. Following the submission of transcript changes and telephonic conferences, the Hearing Examiner advised the Council by letter dated April 16, 1987 that the record had been completed, and he submitted to us a certified index.

At the outset, it should be noted that an assessment of the economic impact of a remedy on NOPSI is not usually obligatory. NOPSI would not have the right to demand that it be undertaken. As the intervenors here correctly point out, a regulator has no general obligation to set rates so as to keep a utility solvent notwithstanding its imprudence. However, the Council believes that it has the right, and an obligation to the community, to investigate the impact on the financial health of the utility and consider that interest along with the ratepayers' interest in prudent utility management, in the overall interest of the ratepaying community. Moreover, there are special circumstances here. Although we believe that a disallowance based on the imprudence of NOPSI's management in retail matters not within the FERC's jurisdiction is fully within our authority, we are reluctant to take action that might prevent, although indirectly, NOPSI's paying its Grand Gulf costs, given the present legal climate and the prior indications of the federal courts.

B. Overview

As indicated above, the economic impact of possible remedial actions was initially assessed by the City's consultants, with NOPSI assuming a "rebuttal" role—although this sequence was not intended by the Council. The approach taken by the City's consultants was based upon financial projections created by using NOPSI's own internal computer models. The existence of NOPSI's models came to light in an earlier stage of the ratemaking proceeding when, on February 5, 1986, NOPSI's senior financial vice president, Mr. McLetchie, filed "Additional Testimony" dealing with NOPSI's projected financial condition. This testimony prompted data requests to NOPSI by the Council's consultants which sought the basis of the financial projections upon which Mr. McLetchie had relied. On April 7, 1986 NOPSI responded by providing computer printouts showing projected sources and uses of funds for a number of years.

On July 23, 1986, in connection with the remedy phase of the prudence proceeding, the Council's consultant's filed a data request seeking "complete financial forecasts," based on NOPSI's computer model, given several scenarios and assumptions specified by the consultants. The scenarios or "cases" included one in which there was no disallowance for imprudence (known as the "9B case"),[72] one in which there was a $50 million disallowance (the "10A case"), one in which there was a $150 million disallowance (the "10B case") as well as others that involved various percentage deductions. The assumptions will be discussed in more detail later.

Technical conferences were held between representatives for NOPSI and the Council relating to the data requests, in order to refine them; to reduce the effort required to produce them; and to deal with problems in the computer runs.

The general approach employed by the Council's consultants was to analyze the results shown in the "cases" to determine whether they portrayed plausible financial situations. If so, then it might be concluded that the imprudence deduction specified in the particular case was one that NOPSI could "sustain."

As described by Mr. Palast, a consultant to the City, the purpose of his testimony was to set "limits" so that an imprudence penalty would be no more than the utility could "sustain" financially—based on the underlying assumption that the utility would take reasonable measures to conserve its cash flow and work in good faith for the success of a financial plan. (CNO Exh. 49 at 5-6.) NOPSI was viewed as able to "sustain" an imprudence penalty if it could thereafter meet its obligations and maintain service—that is, if it could meet its operating and maintenance expenses and interest due on outstanding debt; fund necessary improvements; and, importantly, pay the monthly cost of Grand Gulf I power, as allocated by the FERC. (*Id.* at 6.)[73]

[72] The numbers refer to the paragraph number of the data request filed by the Council's consultants.

Mr. Palast concluded that NOPSI could sustain a deduction of $150 million under either tax regime. He further testified that under the old tax law, NOPSI could have sustained a deduction of $150 million, plus 10 percent per month of the Grand Gulf I costs. Because the new tax law had some adverse effects on NOPSI's after-tax financial results, Mr. Palast's testimony concluded that the 10 percent additional disallowance should be lowered to 4 percent. (CNO Exh. 65 at 27.)

Mr. Cecil, another consultant for the City, also testified that NOPSI could sustain a deduction of approximately $150 million for imprudence, whether the financial computations were made under the old tax law or under the 1986 revision. He concluded that the change in the tax law had only moderately affected the financial impact on NOPSI of the possible imprudence disallowances, notwithstanding the relatively drastic change in the tax rate structure. This, in turn, implied that possible future adjustments in tax rates would also be unlikely to have dramatic impact. (CNO Exh. 68 at 6-8).

Although NOPSI's witnesses vigorously contested these conclusions, they did not offer any alternative "limits." At best, Mr. McLetchie testified that a $50 million deduction would not "theoretically bankrupt" NOPSI. (NOPSI Exh. 85 at 12). Mr. Cecil, in contrast, concluded that a $50 million deduction would leave NOPSI in "a very strong

[73] It is important to understand that the cases do not necessarily portray what would actually be done by NOPSI to finance its obligations and operations—because there are limitless permutations and many options that could be pursued instead. Rather, a case established only that general level of disallowance could be borne by a plausible set of actions, to which there may be many alternatives.

financial condition." (CNO Exh. 68 at 9.) NOPSI's witnesses principally challenged the assumptions used in the computer runs and the feasibility of NOPSI's securing necessary funds through debt and equity investment in the circumstances that would prevail following an imprudence deduction. The evidence was extremely complicated, and witnesses on both sides challenged the methods, calculations and premises of their counterparts.

C. The Financial Projections: Directions and Assumptions

As part of their data requests, the Council's consultants asked NOPSI to provide "a complete financial forecast," in the form of computer runs (including, *inter alia*, an income statement, balance sheet, sources and uses of funds statement), and reflecting the "most recent information available" and the "Company's best judgment with respect to future events." (Data Request of August 4, 1986.) In addition, NOPSI was initially directed to make the following assumptions:

1. The interest rate on future NOPSI financing would not exceed 11 percent.

2. Revenues for the non-Grand Gulf portion of electric operations and for gas operations would not be affected by any imprudence deduction—so that the total revenue figures would be unchanged, except for the deduction itself.

3. Corporate tax laws would remain the same.

4. Grand Gulf II would not be included in the calculations (its future being unknown).

NOPSI's computer runs for the "no deduction" cases ("9a" and "9b" cases) on August 15, 1986 showed the need for additional instructions. Therefore, NOPSI was directed to make the following additional assumptions (which we number as a continuation of the above):

5. The return on average common equity for each calendar year beginning with 1988 would be approximately 14 percent, and the base rate increases necessary to maintain this return would become effective on January 1 of each year.

6. NOPSI's capital structure would maintain the ratios reflected in NOPSI's current capital structure—*i.e.*, long-term debt of approximately 55 percent.

7. Annual common dividends would be no greater than 10 percent of average common equity.

8. There should be no other material changes, but "if NOPSI were to discover some unanticipated error or were to conclude that a further change should be made," it should raise the matter for discussion.

Further discussions between the Council's consultants and NOPSI's consultants and employees followed NOPSI's provision of trial computer runs. Additional instructions and assumptions were provided to NOPSI, by letter dated September 2, 1986, as follows:

9. In addition to the specification that the annual common dividend be no greater than 10 percent of average common equity (as stated in the paragraph numbered 7 above), the annual common dividend should not exceed 70 percent of the "net income available to common" as reflected on NOPSI's Corporate Income Statement.

10. It should be assumed that the capitalization ratios shown on the Financial Statistics of a 55 percent limit on long-term debt and a common equity minimum of 34 percent would be maintained by purchase of NOPSI common stock by its parent, MSU.

Given these specific assumptions, together with the program and assumptions inherent in NOPSI's computer model, NOPSI was requested to provide complete financial forecasts for the period 1986-1995, under a number of "case" scenarios. Each was, furthermore, to be based on the settlement set forth in Resolution No. R-86-112. The cases that became the principal focus of testimony were:

- 9(b): which specified that there would be no adjustment for imprudence.

- 10(a): which specified that there would be, as an imprudence adjustment, a $50 million reduction in the accumulated, deferred Grand Gulf I expenses otherwise recoverable, occurring as of December 31, 1986.

- 10(b): similar to 10(a), but specifying a reduction of $150 million.

- 10(c): which, as revised by letter dated September 18, 1986, specified that, in addition to the $150 million adjustment assumed by 10(b), there be a reduction equal in amount to 10 percent of the non-fuel Grand Gulf I expenses billed to NOPSI.

Succeeding runs under these scenarios also bore a number to indicate their identity. For example, "10(b)(4)" would reflect the fourth (and final) run for 10(b). In describing the output of computer runs below, we shall refer, unless otherwise indicated, to those which reflect the Tax Reform Act of 1986.

It is useful to examine, in the first instance, the 9(b)2 run, since it indicates NOPSI's projected financial condition in the *absence* of any imprudence deduction (but including its obligations under the rate settlement agreement). Under this scenario, NOPSI would be expected to borrow an aggregate of $205 million represented by bonds and debentures during the 5 year period 1986

to 1990,[74] and to repay $108 million of debt during the 5 year period 1991 through 1995. NOPSI would be expected to sell $85 million in common stock to MSU during 1986-1990, and repurchase $98 million of common stock during 1991-1995.[75]

It is important to note that NOPSI would need to borrow debt and seek an equity infusion during the early period even *without* an imprudence penalty. Such need arises from the deferral and phase-in plan contained in the March 1986 settlement. NOPSI would begin to repay this debt and equity financing during the "phase out" period, when its revenues would exceed its Grand Gulf I costs. NOPSI's return on average common equity during the period would be 14 percent, a result dictated by assumption numbered 5, above. The mortgage indenture coverage (the ratio of net income to the interest required to be paid under the mortgage indenture) would generally be in the range of 2.36 to 3.17 throughout the period, except for the first year, which is considerably higher.

In comparison, assuming that NOPSI were to incur a $150 million reduction in deferred Grand Gulf I costs as a result of imprudence (the "10(b)(4) case"), the computerized financial forecasts generally showed the following. NOPSI would have to issue $125 million in debt instruments during the 4 year period 1986-1989, and could begin to repay them in 1990—so that $88 million would be repaid during the 3 year period 1990-1992. NOPSI would issue $105 million of common stock to MSU during the period 1986 to 1989, and commencing in 1990, NOPSI would repurchase its common stock from MSU, so that $105

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[74] The runs were done on the basis of a comparison that began with the year 1986. In fact, however, no imprudence adjustment was made in 1986. The testimony indicated that the periods in question could be moved so as to commence in 1987, without significant impact on the calculation. (Tr. 3387.)

[75] (CNO Exh. 68, EAC-8, Sources and Uses of Funds, p. 3.)

million would be repurchased by 1992. MSU's return on its investment would be lower than in the no deduction case. Its return on common equity would be lowered to approximately 8.8 percent during the period (except for the year of the deduction, which would show a substantial negative return). (CNO Exh. 65 at 16-17.) Similarly, the mortgage indenture coverage would be lowered to a range of about 2.2 percent to 2.6 percent (except for a negative coverage in the year of the disallowance, and a small coverage in the following year). (CNO Exh. 65 at 17.) Again, these results reflect NOPSI's meeting its service obligations, paying its debts, and meeting its obligations to pay for Grand Gulf I.

The fundamental question is whether the results shown by the 10(b)(4) run are plausible and in harmony with real-world financial circumstances. To answer this inquiry, Mr. Cecil stated the key assessment factors as (1) the maintenance of a reasonable percentage of common equity in the capital structure—a factor realized here by the input of assumption 10 above, (2) maintenance of reasonable interest coverage ratios, (3) the existence of a plan which gives assurance to NOPSI and the investors that deferred amounts will be recovered, and (4) sufficient base rate levels for the recovery of non-Grand Gulf costs. (CNO Exh. 46 at 23). He concluded that NOPSI could sustain its operations and meet its obligations given a $150 million deduction, under both the new and old tax laws. (CNO Exh. 68 at 6-8).

Mr. Palast reached similar conclusions as to the 10(b)(4) case. He noted that, except for the year in which NOPSI's books reflect the one-time charge for imprudence, NOPSI would experience positive earnings averaging 8.8 percent in the decade forecasted. He further noted that NOPSI would meet all its interest payments, while otherwise maintaining its operations, "with a comfortable margin of income." Specifically, by the second year after a write-off, the mortgage indenture coverage ratios would exceed 2.0

percent. He also noted that Middle South would not be called upon to invest appreciably more in NOPSI than if there were no write-off at all, and NOPSI would begin returning capital to MSU in 1990. (CNO Exh. 65 at 18-20.)

NOPSI's witnesses reached conclusions substantially different from those of Mr. Cecil and Mr. Palast and contended that NOPSI could not sustain a $150 million imprudence disallowance. In order to highlight these differences and lay the basis for our own conclusions on the issue of relief, we have listed the principal bases of disagreement below. Each of these matters will be treated as separate topics in the discussion that follows. They are:

1. NOPSI's contention that the Settlement Agreement contained an assurance that there would be no disallowance of Grand Gulf I costs in the prudence inquiry; that investors understood the settlement in this manner; and that were this understanding breached, investors would not rely upon any Council "assurance" in the future and therefore would not provide any financing to NOPSI.

2. NOPSI's contention that it is unreasonable to assume that rate relief will be granted on and after January 1 in each year in an amount sufficient to provide a 14 percent return on average common equity—thus challenging assumption number 5.

3. NOPSI's contention that it is unreasonable to assume that debt market funds would be available to NOPSI at 11 percent—or, indeed, on any reasonable terms—thus challenging assumption number 1.

4. NOPSI's contention that it is unreasonable to assume that MSU would make the required equity investment in NOPSI—thus challenging assumption number 10.

5. NOPSI's contention that the effect of the Tax Reform Act of 1986 is so adverse to NOPSI as to make it unable

to sustain an imprudence reduction even if it could have done so under the prior tax law.

6. NOPSI's contention that there are no additional cost savings or cash generation measures available in order to aid its financing in the event of an imprudence deduction.

In the course of examining these principal contentions, a number of related matters will also be treated.

1. NOPSI's contention that the Settlement Agreement precludes prudence relief; issues of investor reliance and retroactive ratemaking.

The rate settlement agreement between NOPSI and the Council of March 20, 1986 (Res. No. R-86-112) provides, *inter alia*, that NOPSI would permanently absorb $51.2 million of the Grand Gulf I non-fuel related costs then incurred—the aggregate of which were then approximately $105 million. It further provides that the remainder of the costs theretofore incurred, as well as future costs, would be deferred and recovered pursuant to a schedule of increases contained in the agreement. For accounting purposes, NOPSI's books reflect revenues (the "deferred revenues") in amounts equal to, and based upon the company's anticipated recovery of, Grand Gulf I costs (and related carrying charges) that are not recovered through rates on a current basis.

NOPSI contends that the settlement bars any imprudence disallowance by the Council that would deny recovery of costs incurred by NOPSI and entered on its books as deferred revenues. This argument appears to have three variations. The first and principal argument is that the Council's approval of the settlement *ipso facto* gave "assurance" to investors that all deferred costs would be recovered. In particular, it is urged that investors who purchased $25 million of NOPSI's first mortgage bonds in July 1986 relied on such "assurances." The second variation is based on a technical and literal reading of the

settlement agreement and contends that the Council is barred by the "plain meaning" of the agreement from issuing an order that would disallow any deferred costs. The third variation is that any such disallowance by the Council would be improper "retroactive ratemaking." The evidence is contrary to NOPSI's position on all of these points.

Our Resolution R-86-112 embodies the rate settlement. The last introductory clause of the Resolution states,

> WHEREAS, the Council deems a settlement to be feasible *only* if such settlement does not affect all existing legal rights of the City, including but not limited to rights concerning municipalization, *the investigation of NOPSI's prudence regarding Grand Gulf . . .*"(Emphasis added.)

In accordance with this premise, paragraph 26 of the Resolution states,

> 26. THE COUNCIL IS NOT REQUIRED TO CEASE ITS INQUIRY INTO THE PRUDENCE OF NOPSI'S INVOLVEMENT IN GRAND GULF OR TO REFRAIN FROM ISSUING ORDERS WITH RESPECT THERETO, UNLESS SO ORDERED BY A COURT OF COMPETENT JURISDICTION.

Paragraph 26 is set in capitalized type and is specifically designated within the agreement as a term "agreed to and accepted by both NOPSI and the Council."

NOPSI's argument that the settlement bars an imprudence adjustment that would reduce deferred revenues rests upon the testimony of expert witnesses that is itself not consistent. Mr. Robert Hahne, a partner of Deloitte Haskins & Sells ("DH&S"), which was an independent outside auditor for NOPSI in 1985 and 1986, testified that the only proper basis for deferring and recording costs under generally accepted accounting principles is the "assurance" that such costs will be recovered; that the settlement

agreement provided such "assurance" with respect to the $54 million booked and deferred by NOPSI in conjunction with the settlement; and that DH&S gave its approval to the settlement on the foregoing basis. (NOPSI Exh. 66 at 4.) Mr. McLetchie, in his deposition, took this idea further and argued that the settlement gave "assurances" that all costs subsequently deferred under the phase-in plan would be "fully recovered according to the agreed upon schedule." (NOPSI Exh. 72 at 88.) Mr. Robert W. Jones, an investment banker whose firm has assisted NOPSI and SERI, stated that while investors recognized that the settlement agreement allows for the prudence investigation, they do not expect the Council to "reverse the deferred revenue already booked by NOPSI." (NOPSI Exh. 67 at 5.) Thus, Mr. Hahne appeared to address only the $54 million booked at the time of the settlement, leaving other future deferred revenues not necessarily subject to the alleged "assurances," while Mr. McLetchie referred to subsequent deferred revenues as well. Mr. Jones' position was not clear.

The testimony of NOPSI's witnesses is refuted by the facts. Prior to the settlement, Mr. Hahne's accounting firm (DH&S) had, in connection with its 1985 audit of NOPSI, issued an auditor's letter with substantial "qualifications" as to NOPSI's ability to continue as a "going concern." At that time NOPSI had incurred a huge Grand Gulf I obligation but had not yet been granted rate relief; and this, in turn, raised questions as to the availability of outside financing. After the settlement, DH&S removed its qualifications—but *not* on the basis suggested by Mr. Hahne that the Council had given the supposed "assurances" or had, by reason of the settlement, barred further disallowances. In an internal DH&S memorandum (CNO Exh. 55), DH&S personnel indicated concern that the settlement agreement left open the prudence inquiry, which "does raise doubt on the recovery of Grand Gulf I costs which *were deferred* in March 1986 in accordance with the set-

tlement and with the *continued deferral*." (Emphasis added.) DH&S did *not* then believe that the settlement gave any "assurance" of recovery. DH&S's partner in charge, Mr. Quivey, dealt with NOPSI's Mr. McLetchie on this matter. Mr. McLetchie did not tell Mr. Quivey that the settlement was an assurance that NOPSI would obtain the deferred revenues. (Tr. 2915.) Mr. Quivey insisted upon receiving the opinion of NOPSI's legal counsel to address the issue. That opinion, obtained in discovery here, did not even suggest that the settlement barred an imprudence disallowance. Rather it implicitly assumed the *opposite* and opined instead that (1) NOPSI would prevail on the substantive issue of whether it was imprudent; (2) certain areas were preempted by federal law; and (3) any imprudence "damages" would not exceed the $51 million already reflected as a deduction in the settlement agreement. (CNO Exh. 56.)

DH&S's internal memorandum squarely places the reason for withdrawal of the qualification in its auditor's letter on the opinion of NOPSI's legal counsel and on its understanding of legal requirements concerning wholesale cost pass-through. (CNO Exh. 56 at 2.) Thus, in connection with a matter of major importance to NOPSI, and at a time when the proposition that the settlement agreement provided the requisite "assurances" would have been of great importance if true, mention of it is conspicuous by its absence. There is no evidence that NOPSI or its counsel asserted that the agreement either literally or by implied "assurance" barred disallowance of deferred costs based on a finding of imprudence, or that DH&S believed this to be true. The evidence is precisely to the contrary.

Similarly, NOPSI's witness, Mr. Jones, testified on cross-examination that in the public offering with which he assisted, (SERI's sale of $750 million of first mortgage bonds in September 1986), NOPSI's rate settlement agreement was considered a "material" event for federal Securities Act disclosure purposes. He affirmed that it was the sub-

ject of the "due diligence" meetings held for the offering. The resulting prospectus language, he said, did in fact inform investors that the prudence inquiry might result in a disallowance and rate reduction. (NOPSI Exh. 68 at 11-12.) Moreover, Mr. Jones subsequently took a contradictory position that we find untenable, to the effect that investors believe that NOPSI was entitled to recover imprudently incurred costs. (Tr. 2744.)

NOPSI's assertion that the "plain meaning" of the settlement prohibits a rate disallowance is meritless. NOPSI apparently contends that because certain conditions or numbered paragraphs were specifically referred to or cross-referenced within certain other portions of the settlement agreement, the fundamental condition dealing with the Council's right to conduct its prudence investigation and to issue remedial orders, which is not specifically cross-referenced, should be disregarded. Post Hearing Brief of New Orleans Public Service Inc., April 10, 1987 at 15 (hereinafter "NOPSI Remedy Brief"). It argues that because the phase-in plan schedule contained no cross-reference to paragraph 26 (referring to the prudence inquiry quoted above), such paragraph 26 cannot provide authority for the Council to authorize a different rate recovery schedule. (*Id.* at 14-5.)

NOPSI goes on to argue, referring to the testimony of Mr. Cunningham (NOPSI Exh. 70 at 38-39), that the only action that paragraph 26 entitled the Council to take, if it found imprudence, was to order a lower return on common equity.[76] Mr. Cunningham's testimony in this regard

[76] NOPSI also suggests that the Council could, under this language of paragraph 26, determine offsetting costs in base rates or "promulgate filing or other regulatory requirements." (NOPSI Remedy Brief at 16.) The former (the determination of offsetting costs), of course, has nothing to do with imprudence. The latter is simply without any substantive content with respect to the instant matter and could affect only future activities.

was, however, elicited on cross-examination, in which he offered his "understanding" of the settlement agreement that the Council was virtually without any authority to issue a remedial order if it found imprudence. Ultimately, Mr. Cunningham testified that he was not told by anyone that there could be no disallowance by the Council of deferred costs set up under the settlement agreement. (NOPSI Exh. 70 at 42, 47). He finally conceded, "I am not going to say that somebody told me what the Council could do if they found imprudence." (*Id.* at 47.)

Mr. Cunningham was also allowed, over objection, to testify that if the Council were to issue an order that had the effect of preventing NOPSI from recovering the costs that it had booked as deferred revenues under the settlement, such a disallowance would constitute "retroactive ratemaking" and would thus be prohibited. (Tr. 2771 *et seq.*) This matter was a question of state regulatory law and did not require Mr. Cunningham's testimony; nor was he competent to testify on the matter. Moreover, NOPSI's brief here cites no legal authority that would support Mr. Cunningham's contention and we independently have found none. It is obvious that the imposition of such a disallowance would not constitute retroactive ratemaking because it was based on a right expressly reserved within the settlement order itself and involves rates that were expressly made subject to a possible remedy for imprudence.

On cross-examination, Mr. Cunningham was also confronted with NOPSI's Form U-1, filed under the Public Utility Holding Company Act of 1935, dated September 23, 1986 (CNO Exh. 61), which was inconsistent with his testimony. The disclosure set forth on page 10 of NOPSI's financial statements stated, in part, with respect to the prudence inquiry that,

> If the Council determines that any such actions or decisions were imprudent . . . it may attempt to prohibit the company from recovering from its

> ratepayers those costs associated with Grand Gulf I . . . incurred as a result of imprudent actions or decisions in excess of the unrecovered $51.2 million resulting from the settlement between the Council and the Company. However, the Company believes that all of its actions and decisions with respect to Grand Gulf I were prudent and that the company would ultimately be successful in defending against any attempt to quantify a finding of imprudence in excess of $51.2 million.

It goes on to state,

> The Company cannot predict the effect, if any, of the revised decision of the Court of Appeals in the course or outcome of the Council's prudence investigation and related litigation. (*Id.*)

Again, there was no suggestion in NOPSI's disclosure that the Council was barred by either the settlement order or rules against "retroactive ratemaking" from disallowing, on the ground of imprudence, costs "in excess of the unrecovered $51.2 million." Moreover, the language further undercuts the claim that the settlement provided an "assurance" of recovery.

NOPSI's contentions place the Council in the unusual position of being told that it agreed to something other than that which we agreed to, and then being asked to adjudicate the matter. The rate settlement was made subject to the Council's continuing authority to conduct the prudence investigation and issue orders with respect to it. NOPSI and the investment bankers clearly understood that a common form of relief, if imprudence were found, would be an order disallowing imprudently incurred costs. (NOPSI Exh. 68 at 10-11.) The effect of the settlement is that NOPSI is entitled to rate relief under the schedule set forth therein, provided that no subsequent findings of imprudence were made and related penalty imposed. Such was the understanding when the agreement was entered

into. Moreover, we believe that NOPSI had an advantage in some respects with respect to predicting the outcome under paragraph 26, because at the time the settlement was reached, it had greater knowledge of facts bearing on its prudence. NOPSI accepted the risk that the evidence in the prudence inquiry might result in a finding of imprudence and an appropriate remedy. There is no bar to the Council's ordering relief that disallows the recovery of costs imprudently incurred.

2. NOPSI's contention that the financial forecasts are based on the unreasonable assumption that the Council would grant regular annual rate relief sufficient to maintain a 14% return on average common equity.

As previously indicated, NOPSI was directed by letter dated August 21, 1986, to include an assumption[77] in the financial forecasts regarding NOPSI's return on average common equity. This was based on the assumption that the Council would give periodic relief to cover increases in costs other than those associated with Grand Gulf I—which Mr. Cecil testified was no more than the assumption that the Council would act reasonably. (Tr. 1989.) Mr. McLetchie characterized this as a "highly questionable assumption," since, he said, it would require the Council to

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[77] The relevant text of the letter relating to the assumption is as follows:

> NOPSI should assume a 14 percent annual return on average common equity for each calendar year beginning with the year 1988. This assumption will require the computer model to factor in annual base rate increases necessary to maintain the 14 percent annual return on average common equity. The forecasted base rate increases should be presumed to become effective on January 1 of each year, beginning with January 1, 1988. We understand that, to simplify the modeling procedure, the forecasted base rate increases will be shown entirely on the electric side. We also understand that the computer model may not produce precisely a 14 percent return on equity in each year, and that the return may vary a few tenths of a percent in one direction or the other.

grant "prior to January 1 of each year, rates sufficient to cover the expenses of Public Service for the coming year and to allow Public Service to earn a 14% return on equity calculated as though there had been no prudence hit. It certainly has not been established that the Council would be willing to grant those increases." (NOPSI Exh. 71 at 4.)

The background of this assumption is important. On August 15, 1986, NOPSI provided financial projections to the Council's consultants that portrayed NOPSI as going bankrupt (or at least suffering continuous losses), even *absent* any imprudence deduction (*i.e.*, the original 9(b) case). This portrayal resulted from NOPSI's decision not to reflect any rate increases to cover increased costs arising from matters other than Grand Gulf. (CNO Exh. 49 at 40-41). That is, NOPSI *included* such increased non-Grand Gulf *costs* in the projections (about $250 million) but did *not* include any *revenues* from rate increases to offset such costs.

It appears that NOPSI's decision to omit non-Grand Gulf rate increases was intentional. Mr. Louiselle testified that in presenting the Council with forecasts that showed no rate relief responsive to increases in non-Grand Gulf expenses, NOPSI made a conscious decision to omit such rate relief, even if it portrayed NOPSI as going bankrupt. (NOPSI Exh. 79 at 92-96). He justified this on the basis that Mr. Palast had given testimony in the rate proceeding here (during the non-prudence phase) that any rate increase over 6 percent annually would have "catastrophic" results. (NOPSI Exh. 78 at 10). Mr. Palast did not so testify, but rather stated that annual rate increases over 6 percent would have a "measurable" impact on the community—*i.e.*, the adverse effects could begin to be measured—not that any increase over 6 percent would be a catastrophe.

NOPSI's position was inconsistent with that taken in NOPSI's own projections submitted in April 1986, (NOPSI Exh. 78 at 95-6), as well as with its normal forecasting practices—both of which assumed that there would be rate increases in the ordinary course to cover increased non-Grand Gulf costs, plus a return on investment. (NOPSI Exh. 72 at 45-47). The contrary assumption, implicit in the computer forecast presented by NOPSI on August 15, 1987, was not realistic or justifiable. (See cross-examination of Mr. Louiselle. Tr. 3027-29).

To rectify these implausible financial results, the Council's consultants instructed NOPSI to include a rate relief assumption which contained two necessary specifications: the level of return on investment that would be allowed by the Council and when it would be effective. NOPSI now asserts that this assumption is unreasonable because "It has not been established that the Council would grant such increases", (NOPSI Exh. 71 at 4) and that it is unrealistic to assume that the increases will occur as of the beginning of each year.

Mr. McLetchie conceded that the Council's methodology was essentially correct—that is, in the normal course of events NOPSI would periodically determine whether its rates were sufficient to recover costs plus a reasonable rate of return on equity, and would seek rate relief if it appeared such costs would not be recovered. (NOPSI Exh. 72 at 55-57, 60.) He contended that the assumption that rate relief would be granted by the Council each January was artificial, considering that in real world circumstances, relief would likely be sought at irregular time periods. But he conceded that NOPSI's requests for relief would in fact be timed and quantified so as to account for expectable regulatory delay. (*Id.* at 45-47 *et seq.*)

It is important to note that NOPSI did not offer any more "realistic" assumption to address this problem, even

when pressed to do so by attorneys for the Council. (*Id.* at 62-63.)

For the purpose of developing financial projections to assess the level of imprudence adjustment that NOPSI could sustain, the assumption was a reasonable one. It is not necessary to believe that the Council will grant relief each January 1. Rather, the essence of the assumption is that NOPSI will be given timely rate relief that will cover legitimate increased expenses together with a reasonable return on rate base. Moreover, the utility of the assumption is a matter in which the Council plays a direct role. We have control of how much rate relief we will grant and how quickly we will do so. Basically, the Council can make the essential character of the assumption work, which NOPSI concedes. (Tr. 2933-34). The Council recognizes the need to deal fairly with future NOPSI requests for non-Grand Gulf I rate relief in a timely manner, and this consideration may be deemed embodied in our order issued herewith.

3. NOPSI's contention that the forecasts are based on the unreasonable assumption that NOPSI could obtain debt financing at the rate of 11%; and its further contention that it could not obtain debt financing on any reasonable terms.

As previously indicated, the computer-generated forecasts for the $150 million deduction case (*i.e.*, case 10(b)(4)) show NOPSI borrowing $125 million during the period 1986-1989, and beginning to repay its lenders in 1990. NOPSI objects to this portrayal as unrealistic on a number of grounds, summarized as follows: (1) The forecast is unrealistic because it was based on its assumption that NOPSI's cost of borrowing would be 11%, which is unreasonably low; (2) NOPSI will, in fact, be unable to borrow on any reasonable terms, because of low income-to-interest coverage ratios and other financial circumstances that will arise following the imprudence "hit"; (3) the willingness of lenders to provide debt financing would be dependent upon the commitment of MSU to provide equity financing contemporaneously, and MSU will not provide such financing.

The dispute over the appropriate interest rate applicable to NOPSI's borrowing is less consequential than may first appear. NOPSI argues that if there were a large imprudence disallowance, the rating of its bonds would be reduced below "investment" grade to a "speculative" level,[78] and that this would narrow the number of potential investors considerably and would raise the interest rates NOPSI would have to pay. Although NOPSI issued $25 million in bonds in July 1986 at 11 percent, NOPSI notes that such bonds were ultimately to be secured by a property mortgage, while here there would be no property available to secure the debt financing required. Given these and other circumstances, its experts concluded that NOPSI would have to pay 12.5 percent to 15 percent in order to borrow the necessary funds. (NOPSI Exh. 71 at 6-7; NOPSI Exh. 67 at 9-10.)

The City's consultants noted that the 11 percent interest rate was specified by them only after NOPSI had provided runs that incorporated excessive 15.25 percent and 17.0 percent interest rates. They further noted that top-rated utilities were paying an average of about 9 percent on their borrowings, and that 11 percent represented a substantial premium; that SERI, which had "many of the risk characteristics of NOPSI," had sold a large issue of medium term bonds in September 1986 at 11 percent (NOPSI Exh. 49 at 45-47); that SERI subsequently sold $750 million of debt at between 9.96 percent for 5 year bonds to

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[78] Bond rating agencies have various classifications of the investment quality of a particular issue, utilizing a combination of letters. The fact that an issue is rated as "speculative" does not mean that it cannot be sold, but it would affect terms such as the interest rate and probably reduce the number of potential buyers.

11.65 percent for 30 year bonds; and that other "troubled utilities" had been able to raise debt at interest rates considerably below those proposed by NOPSI. (CNO Exh. 50 at 22; CNO Exh. 47 at 139-42).

It may be assumed *arguendo* that the interest rate NOPSI would have to pay lies somewhere in between these conflicting positions.[79] The more important point is that a change in interest rate of the magnitude involved here would not fundamentally affect NOPSI's ability to withstand an imprudence disallowance. A higher rate would become a legitimate cost of NOPSI "normally included in rates and paid by the ratepayers." (CNO Exh. 47 at 172-4.) NOPSI's witness Mr. McLetchie agreed that the Council has the power to grant rate increases that would allow NOPSI to recover its interest costs, whatever they may be. (Tr. 2936-38). Moreover, although a change in the level of interest rates might also play a role in calculating the income-to-interest coverage ratios, this would not be significant. (CNO Exh. 47 at 173.)

There was also considerable debate among the expert witnesses as to whether the coverage and capitalization ratios depicted in the financial projections were "healthy," "adequate" or "reasonable." (See NOPSI Exh. 67 at 7.) There was similar debate as to how NOPSI's situation would compare to those of other "troubled utilities," a number of which have obtained financing and maintained operations notwithstanding major disallowances for imprudence. (NOPSI Exh. 68 at 41-43.) It is probably not possible or necessary to reach conclusions, in the first instance, as to whether such situations are sufficiently comparable in important respects to provide definitive guidance. It is important, however, to note that even NOP-

[79] In May 1987 NOPSI issued $75 million of 10 year Rate Recovery General and Refunding Mortgage Bonds at 10.95 percent interest. In January 1988 NOPSI issued $40 million of similar bonds at rates ranging from 13.2% to 13.9% depending upon maturity.

SI's witness did not contend that the necessary financing would be unavailable, but only that it would be "very difficult" for NOPSI to be "assured" of its ability to raise funds, if its debt securities were downgraded to "speculative" ratings. (NOPSI Exh. 67 at 9; NOPSI Exh. 79 at 74-79.) However, the level of the interest rate offered plays a key role in making such an investment attractive. (Tr. 2938-39.) Moreover, the assurance most critical to lenders is that they will in fact be repaid, and this appears to be a certainty under the projections. Both of these matters, it must be noted, can be addressed by actions of the Council.

Moreover, the projections in the 10(b)(4) case, which must be regarded as conservative,[80] show that NOPSI's mortgage indenture coverage ratio exceeds 2.0x throughout the forecast period, except for the year of the write-off and the next succeeding year (CNO Exh. 65 at 17, GP-8)—a respectable margin for debt coverage.[81] Assuming other specifications in the 10(b)(4) scenario were met, particularly that of equity financing, there seems to be little question that NOPSI would be able to repay its borrowings in a relatively short time, so that long-term financing would not be required, even in the case of a $150 million write-

[80] As indicated in point 5 *infra*, NOPSI's 10(b)(4) case, reflecting projections under the new tax legislation, tends to understate NOPSI's net income.

[81] Assuming a write off of $150 million in a single year, the mortgage interest coverage in the year of the write-off is negative, reflecting the loss that would occur. The next year is 1.57 and all succeeding years exceed 2.0 (CNO Exh. 65 at GP-8). Under the terms of NOPSI's first mortgage bond indenture, NOPSI can issue additional first mortgage bonds only if pre-tax earnings are at least 2.0x the interest due on first mortgage bonds outstanding and to be issued—which, of course, specifies a margin of earnings over its interest requirements. It would not be expected that financing would be based on first mortgage bonds, so their coverage ratio would not act as an operative restriction. Other kinds of debt may be issued (See CNO Exh. 49 at 22-23; CNO Exh. 46 at 14).

off, and this should allow a more favorable interest rate. Mr. Palast noted, "By 1990, the Company may stop borrowing altogether and begin a long period of cash surplus during which time it will pay down debt and refund capital to MSU." (CNO Exh. 65 at 15.) Mr. Cecil emphasized that the key factor here was to assure the debt investors that they will in fact get their money back with interest through recovery of deferred costs. (Tr. 3356; CNO Exh. 46 at 13; Tr. 1991).

Because prospective lenders would be assured of being paid back on a timely basis, at an interest rate reflecting market risk, a determinative element here appears to be MSU's willingness to provide the equity that would be deemed necessary to complement the debt financing[82] and give confidence to the debt investors. This matter is treated in the next section.

4. NOPSI's contention that it is unreasonable to assume that MSU will make the equity investment in NOPSI required to fulfill the financial projection.

Under the $150 million deduction case, NOPSI would need to sell $105 million of its common stock to MSU over a 4 year period, as follows: 1st year - $25,000,000; 2nd year - $40,000,000; 3rd year - $20,000,000; 4th year $20,000,000. (CNO Exh. 68, Case 10(b)(4), Sources and Uses of Funds, p. 3.) Beginning in the fifth year, NOPSI could begin repurchasing the stock, and complete the repurchase within three years. (*Id.*)

NOPSI contends that MSU would be unwilling to make such an investment in the circumstances presented. The return on MSU's newly invested equity would be in the

[82] An equity-to-debt ratio of 30% is required by the Securities and Exchange Commission.

range of 9.5% annually,[83] which NOPSI considers too low and embodying a "double penalty."[84] Moreover, NOPSI's witnesses raised the prospect that during the time when MSU would be required to make the investment, the preferred shareholders would have the right to take over NOPSI's board of directors, and that this in turn would make it highly improbable that MSU would be willing to invest any substantial sums.

This, it is said, would come about as follows: Because of the imprudence deduction, NOPSI would have a negative retained earnings balance through the end of 1991. (Tr. 2181, regarding Case 10(b); CNO Exh. 68, regarding Case 10(b)-4.) As a result of a limitation in NOPSI's charter and elsewhere, NOPSI could not pay preferred dividends in these circumstances.[85] Moreover, if NOPSI does not pay such dividends for four quarters, NOPSI's preferred shareholders, rather than MSU, can elect its board of directors. Thus, MSU would, NOPSI argues, be called upon to make significant investments in NOPSI under the "catastrophic condition" of the threat of a loss of control of the board,

[83] In fact, Mr. McLetchie contended that MSU should properly look at the rate on its total historical invested equity, or about 2.6 percent annually, not the 9.5 percent that it would earn on the aggregate equity remaining after the deduction together with newly invested equity. (NOPSI Exh. 72 at 114-117.) However, it seems to us that any investor, including MSU, would make its decision based on present and future returns, not on historical investments and not on losses incurred as a result of imprudence, which expectably is a non-recurring extraordinary event.

[84] Contrary to NOPSI's contention that the lowered rate of return constitutes a "double penalty", it is merely a mathematical result of the write-off itself. (CNO Exh. 51 at 151-2.)

[85] In their original analysis of NOPSI's computerized forecasts, the Council's consultants assumed that NOPSI could pay preferred dividends during this period. However, the misunderstanding arose because NOPSI's printouts erroneously showed such dividends being paid. (Tr. 2326.)

and MSU would not reasonably do so. (NOPSI Exh. 67 at 14; NOPSI Exh. 68 at 58-59.)

The prospect of the preferred shareholders' taking over the board is, however, not realistic. Even assuming that the preferred shareholders had the legal right to elect the board, they could not practicably do so for the very reason that they would need MSU's investment in NOPSI, and MSU would not make that investment if the preferred shareholders took actions to disturb MSU's control. (NOPSI Exh. 68 at 62.) The theoretical right of the preferred shareholders to take over the board would be neutralized by their need for MSU's investment. (*Id.* at 80-81.)

NOPSI's witness, Mr. Jones, who principally sponsored this argument, was pressed to explain what the preferred shareholders could do that would be adverse to MSU. Apart from stating conclusorily that they might take actions "beneficial" to themselves and "detrimental" to MSU's equity, Mr. Jones was unable to suggest any specific act that would help them but hurt others. (NOPSI Exh. 68 at 62-68.) At one point he suggested that the preferred shareholders might force the company into liquidation to reclaim their equity and accrued dividends. However, it is unlikely that, during the five year period of NOPSI's negative retained earnings, the preferred shareholders would be able to realize their investment in a liquidation. (*Id.* at 72-76.) Instead, they would have the compelling incentive to continue the company as a going concern and attempt to secure MSU's continuing investments.[86]

We believe it evident that it would be in MSU's interest to make, and that it would in fact make, the investment required to ensure NOPSI's success following an imprud-

[86] Apart from the facial implausibility of the threat that the preferred shareholders would take over the board, there was other expert testimony that the risk to MSU was insubstantial (Tr. 2130), and that in similar circumstances where a utility had passed preferred dividends, the preferred shareholders took no action. (CNO Exh. 51 at 130-2, 141.)

ence deduction. MSU would have to make substantially the same equity investment whether or not there were any imprudence deduction, and it will get its money back beginning in 1990. (Tr. 2127; Cecil Dep. CNO Exh. 47 at 92; CNO Exh. 65 at 20, 28, Exh. GP-13.) Assuming that MSU will be repaid as the projections indicate, the only disadvantage MSU might incur is earning 9.5 percent on its investment instead of 14 percent. However, MSU's management would have to consider, against this, the consequences if MSU did not make the investment. In that circumstance, MSU would be likely to lose the entirety of its historical investment in NOPSI, which even after a $150 million deduction, would be approximately $25 million, and MSU probably would lose the right to future control of NOPSI. (NOPSI Exh. 72 at 121-128.)

Ultimately, of course, the Council has the power to take steps necessary to assure that MSU will be in a position to begin recovery of its equity investment within a few years after making it and to recover substantially all of it. One of the Council's own expert witnesses, Mr. Cecil, testified that MSU should be given such an assurance. (CNO Exh. 47 at 83.) Mr. McLetchie, in turn, testified that—(1) if the Council did undertake to provide NOPSI periodically with adequate rate compensation for its increased non-Grand Gulf expenses to assure debt investors that their principal will be repaid along with compensatory interest, and to give MSU the aforementioned 9.5 percent return on its investment; and (2) if the debt investors indicated that, having been given the aforesaid assurance of recovery, they would invest if MSU also did so—then he could not say that MSU would not invest, and that such circumstances constituted a "great improvement." (Tr. 2933-2964.) In short, the Council can largely control or influence the actions that would make the plan work.

Finally, while NOPSI seemed to suggest that MSU did not have, or could not get, the funds necessary to make the investment (CNO Exh. 47 at 117; Tr. 2025), it appears

that, as of the time of the hearing, MSU had $150 million in available, temporarily invested funds (NOPSI Exh. 86 at 76-77) and probably could raise more. In any one year, MSU's investment would not exceed $40 million. (CNO Exh. 68, Case 10B4, Sources and Use of Funds, p. 3.)

We conclude that the financial projections shown for the $150 million deduction case are, on the evidence, feasible and plausible.

5. NOPSI's contention that the Tax Reform Act of 1986 is so adverse that NOPSI could not sustain a significant imprudence deduction even if it could have done so under the prior tax law.

For the most part, analysis of this contention is subsumed in the prior discussion because we used as our starting points the 9(b)(2) and 10(b)(4) cases, both calculated consistently with the Tax Reform Act of 1986. Thus, the conclusions we have reached do in fact take into account the effects of the new tax law.

Moreover, NOPSI's computer forecasts for the 10(b)(4) case, upon which we have relied, appear to contain two errors that portray financial circumstances more difficult than should be the case. First, the imprudence deduction itself would have a tax effect. The aggregate revenue reduction resulting from the imprudence penalty would result in a lower tax payment and thus more net post-tax income. However, in calculating the results of the new tax laws in the 10(b)(4) case, NOPSI showed the detrimental aspects, but it failed to include the tax reduction effect of the write-off; in fact, it merely used the same taxes shown in the no-deduction 9(b)(2) case for the 10(b)(4) case. (CNO Exh. 68 at 4.)

This was a "substantial error." (*Id.*) The overall understatement of NOPSI's revenues in the 10(b)(4) case was $170 million. (Tr. 3152.) Although most of this additional revenue would be realized by NOPSI in later years, especially 1993 to 1995 (CNO Exh. 68 at 4), nevertheless it would certainly be of importance to debt and equity investors as additional funds available to repay them for the investment made during the earlier "phase-in" years, when NOPSI's revenues would be less than its expenses. (Tr. 3241 *et seq.*)

Another error in the 10(b)(4) run, less substantial in amount, affects the calculation in the earlier years of the effect of the alternative minimum tax ("AMT"). Under the AMT, half of the difference obtained by subtracting income for tax purposes from book income is treated as a "preference" item on which a ten percent tax must be paid. (This results in an AMT credit carry-forward, usable against taxes in later years.) In the early years, 1987 to 1992,[87] NOPSI would experience a "negative difference" between its book and tax income; this could be used to reduce the consolidated taxes of the several Middle South system companies, which file a consolidated return. There is an Intercompany Tax Agreement ("ITA") among these companies that prescribes, *inter alia*, that a company contributing to a tax reduction generally realizes the benefit of the contribution. While the current version of the ITA does not specifically contemplate the operation of the amended AMT, Mr. McLetchie testified that it would be his position that NOPSI should realize the benefit of the AMT reduction it will have generated as a result of the imprudence disallowance. (NOPSI Exh. 68 at 59-68.) Such a result would make several million additional dollars available to NOPSI in the earlier years. (CNO Exh. 50 at 9-10.)

Finally, it appears that the changes in the tax law work complementally with NOPSI's cash demands. In the three year period 1987 to 1989, NOPSI would actually fare about

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[87] These time periods were based on assumptions in the testimony of a prudence adjustment occurring in 1987. However, the same basic conclusions pertain if the time periods commence in a later year.

$12 million better under the new tax law than previously, and this is a period in which NOPSI would have substantial cash needs because of the "phase-in." In the next three-year period, 1990 to 1992, NOPSI would fare $27 million worse under the new law, but it is a period in which NOPSI would, in the aggregate, receive a tax refund and, beginning in 1990, be in a position to begin retiring the investments made to finance the imprudence deduction. In the next three year period, 1993 to 1995, NOPSI would actually fare $98 million better under the new tax law. (Tr. 3160 to 3192.)

In summary, we believe that Mr. Cecil correctly concluded that the new tax law has not drastically changed the impact under the 10(b)(4) case of a $150 million deduction, and that this is suggestive that future tax changes are not likely to have dramatic impact either. (CNO Exh. 68 at 6-8.)

6. NOPSI's contention that there are no additional measures available to aid NOPSI in its financing in the event of an imprudence deduction.

The foregoing conclusions have been reached without taking into consideration any specific cash conservation measures available to NOPSI other than those inherent in the computer forecasts. However, certain additional measures were suggested by Mr. Palast, and there was extensive testimony as to the availability of funds arising from the reconstitution of NOPSI's pension plan. These matters are treated below.

Mr. Palast suggested that NOPSI could utilize capital leases and sale-leasebacks in order to boost its cash flow—at the level of 50 percent of NOPSI's new plant spending—but without resort to selling and leasing back major current assets, including NOPSI's headquarters. (CNO Exh. 49 at 54.) NOPSI has responded that this level is unrealistically high in that the balance of forecasted construction additions for 1987 through 1995 ranges from $21 million

to $31 million per year, and about $17 million to $21 million per year is needed to back certain of its debt obligations, leaving about $6 million per year available for leasing to provide cash flow, and this is further constrained by tax laws. (NOPSI Exh. 71 at 22.) The evidence is not sufficiently developed for us to reach a conclusion in this matter, beyond stating that some undetermined amounts could be utilized for a leasing program to generate cash flow.[88]

It was also suggested that NOPSI could utilize short term borrowing and finance its accounts receivable. NOPSI was, it turned out, able to secure a line of credit from Hibernia Bank in the amount of $10 million following the rate settlement. NOPSI contends, however, that a substantial disallowance would trigger a "no material adverse change clause" in the credit agreement and possibly preclude further use of the line of credit. (NOPSI Exh. 71 at 23.) NOPSI apparently also has access to short term borrowing from the Middle South money pool, an arrangement in which companies in the System either lend excess funds or borrow on a short-term basis. NOPSI contends that all borrowings are "on demand" and are available only on a short term basis, not compatible with the financing needs posed by an imprudence deduction. (*Id.* at 24.) Moreover, regarding accounts receivable financing, NOPSI did in fact enter into an arrangement for accounts receivable financing in the amount of approximately $25 million, but its ability to utilize this source may, as a practical matter, be limited.[89]

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[88] As previously indicated, NOPSI sold $75 million in new bonds in May 1987. The terms of the indenture underlying the bonds prohibit sale and leaseback arrangements. However, those terms may have to be renegotiated for other reasons in view of the Council's action here, and we do not therefore take such restrictions to be necessarily inflexible. Similar terms were contained in NOPSI's issuance of $40 million of bonds in January 1988.

[89] Subsequent to the hearings, NOPSI issued $75 million in General

Another possible measure available to the Company is the recapture of excess funds from NOPSI's pension plan. (CNO Exh. 49 at 54-55.) Extensive testimony was taken on this issue from the Council's consultant, Mr. Camus, and from Mr. Haneberg, the actuary for NOPSI's pension plan.

NOPSI's pension plan is a "defined benefit" plan, which is to say that the plan specifies the benefits to be paid to NOPSI's employees upon their retirement. (CNO Exh. 48 at 4; NOPSI Exh. 80 at 2.) NOPSI's plan generally defines annual benefits as a percentage of a beneficiary's highest five year average salary multiplied by the beneficiary's years of service in the Company. (CNO Exh. 48 at 5; NOPSI Exh. 80 at 2.) NOPSI makes annual contributions to the plan in amounts calculated, by actuarial methods, to provide these benefits. (CNO Exh. 48 at 4.) The plan's benefits do not increase automatically when the plan becomes overfunded. (*Id.*) Rather, NOPSI must formally amend the plan to effect an increase in benefits. (*Id.*)

Mr. Camus testified that NOPSI's pension plan is overfunded, and calculated the excess assets in the plan to be $31.2 million as of December 31, 1985. (*Id.*) He estimated that the excess amount could have grown to $41 million by mid-1986, due to gains in the stock market during the first half of that year. (*Id.* at 8-9.) Mr. Camus testified that these excess funds could be recaptured for the Company's use following termination of the plan, with full protection for NOPSI's employees and retirees. (*Id.* at 3-4.)

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and Refunding Rate Recovery Bonds, the terms of which restrict its use of short term borrowing and accounts receivable financing. Specifically, NOPSI was obligated to terminate the latter by August 21, 1987. It cannot incur short-term debt (one year or less maturity) above a formula limitation. For reasons previously indicated, the specific terms that NOPSI negotiated with its lenders in this instance may not be absolute restraints.

According to Mr. Camus, such terminations are becoming a common means for companies to free up excess pension plan assets. (*Id.* at 3.) Termination of plans, and reversion of funds to the employer, are governed by the federal Employee Retirement Income Security Act, as recently amended by the Single Employer Pension Plan Amendments Act of 1986 ("SEPPAA"), which simplified and shortened termination procedures. (*Id.* at 9.) Upon termination, plan assets are distributed to beneficiaries in the form of insurance company annuities, and excess assets revert to the employer. (*Id.* at 13.) The employer may elect to establish a new plan for future accruals of benefits. (*Id.*)

Mr. Camus emphasized that NOPSI's employees and retirees could be protected from any losses to their expected benefits under these procedures, and depending on the size of the insurance carrier chosen, would likely be *safer* from loss than under the current NOPSI plan. (*Id.* at 13-15.) Benefits accrued at the time of termination would be guaranteed by the insurance company, which typically has surplus funds much greater than the surplus of NOPSI's plan. (*Id.* at 15.) The Equitable, for instance, had surplus funds in excess of $1 billion at the time of Mr. Camus' testimony. (*Id.*) Further, future accruals of benefits could be provided through the establishment of a new plan, at NOPSI's discretion. (*Id.* at 14.) Mr. Camus cited a recent study commissioned by the federal Department of Labor, which studied 97 representative termination applications pending before the Pension Benefit Guarantee Board after January 1984. The report concluded that individuals' accrued benefits at the point of termination were "fully protected." (CNO Exh. 48 at 11.) Moreover, all but six of the 97 plans were replaced with new plans, most of which provided identical or greater benefits than their predecessors. (*Id.*)

The basic elements of Mr. Camus' testimony are undisputed and, for the most part, are supported by the testimony of Mr. Haneberg. Mr. Haneberg testified that the NOPSI plan is overfunded (Tr. 3057), and agreed that Mr.

Camus' figure of $31.2 million was a reasonable estimate of the excess on a termination basis. (NOPSI Exh. 80 at 8; Tr. 3058.) In fact, Mr. Haneberg performed his own calculation of the excess as of October 1, 1985, and found it to be $30,900,000. (NOPSI Exh. 80 at 5.) He did not offer a more recent figure. Mr. Haneberg knew of no legal impediment to termination of NOPSI's plan (Tr. 3058) and agreed that the excess funds, with certain adjustments, would revert to the Company upon termination. (Tr. 3058.)

We conclude that termination and reestablishment of NOPSI's pension plan could provide the company with an influx of cash. Although the reversion may be subject to one or more significant offsets (including, for instance, a ten percent federal excise tax, *see* CNO Exh. 48 at 16-17; NOPSI Exh. 80 at 8-11), as well as to fluctuations in the stock and bond markets, the amount of the reversion is potentially several tens of millions of dollars.

The Council also takes no position as to whether NOPSI *should* terminate and reestablish its pension plan, but merely notes that this source of cash is available. Moreover, it may be proper that the money resulting from the reestablishment of the plan should promptly be returned to the ratepayers.

Mr. Palast suggested that upon termination, NOPSI should be granted free use of the reverted funds to finance a portion of its phase-in expenses, but that the funds be returned to consumers by amortizing the sum to rate income over twenty years. (CNO Exh. 49 at 54-55.) We do not rule on this matter as neither the termination of NOPSI's plan nor the ratemaking treatment of the reverted funds is presently before us.

We also note that the witnesses took issue over several matters, including the extent to which adjustments would partially offset the reverted funds, the timing of the reversion, and the cost of a new plan. None of these undermine our conclusion that termination and re-

establishment of NOPSI's pension plan could free up millions of dollars.

In short, while the amounts remain unclear, and while we do not rely on the availability of financing from any of the measures noted above, NOPSI appears to have other significant sources of funds available to it to meet its financing needs following an imprudence deduction.

VIII. IMPRUDENCE DISALLOWANCE

On the basis of the record before us, we conclude that NOPSI's conduct fell short of prudent utility management, to the detriment of its ratepayers and its shareholders as well. NOPSI's conduct has resulted in higher than prudently-incurred costs to the company and an unnecessarily strained financial condition. We conclude that a disallowance in rates is warranted in order to spare the company's retail ratepayers from the full consequences of management imprudence and, in line with traditional ratemaking law, that NOPSI's shareholders should bear the consequences of management imprudence. However, the disallowance remedy we will direct in the circumstances here recognizes the need to balance the interests of the company's ratepayers with those of its shareholders (and creditors) and the particular circumstances in which this matter has arisen.

If NOPSI were a company with greater financial resources, a larger disallowance than what we order here could be considered, without imperiling the company's ability to continue to pay its monthly bills to SERI for power purchases from Grand Gulf I and continue as a going concern. The reality is, however, that NOPSI has limited financial resources. As a result, NOPSI, on the evidence here, can sustain only a limited disallowance in rates for imprudence, and still continue as a viable concern making payments to SERI for Grand Gulf I power and meeting

its responsibilities. We do not think it unreasonable to create a remedy appropriate to these circumstances.

Accordingly, the Council directs that $135 million of NOPSI's currently deferred Grand Gulf I expenses be disallowed from recovery in retail rates in the future. This disallowance is in addition to the $51.2 million absorbtion of deferred Grand Gulf I expenses that NOPSI agreed to in March, 1986. A one-time write-off of $135 million in 1987 is within the limits which NOPSI can sustain and still continue its payments to SERI, according to the evidence. In fact, the $135 million disallowance is somewhat less than the $150 million amount (and more) which certain experts concluded is sustainable. The reduced disallowance will, in our view, provide a buffer or margin of approximately ten percent to allow for the uncertainty inherent in financial projections and for the possibility that circumstances could change to NOPSI's detriment.

A one-time write-off of $135 million will, of course, have a substantial effect on NOPSI's financial condition for one or two years, following which time it is expected that NOPSI's financial condition will improve rapidly. Even during this time, however, NOPSI will be able to continue to pay its bills to SERI for Grand Gulf I and remain a viable concern. This assumes willingness by NOPSI's shareholder, MSU, to infuse a reasonable amount of common equity in NOPSI (to be repaid to MSU in the early 1990's). We believe such an assumption is fair and warranted, because shareholders should share the cost burden[90] of managerial imprudence and in light of the Council's

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[90] NOPSI's ratepayers already share this burden to the extent that the $135 million disallowance ordered is less than half of what Mr. Komanoff recommends, at the low end of his range. Mr. Komanoff found that the imprudence of NOPSI's management kept NOPSI from realizing savings amounting to between 62 and 31 percent of its cost of Grand Gulf I. A $150 million disallowance would represent approximately 16 percent of the cost of Grand Gulf I to NOPSI. (Tr. 3331.)

efforts to maintain NOPSI's solvency and ability to discharge its responsibilities by adopting a moderate imprudence remedy.

Mr. Cecil presented three alternatives to adjust NOPSI's rates to reflect a disallowance by the Council here. (CNO Exh. 68 at 9-11.) We believe that NOPSI's ratepayers should see some of the effect of the disallowance, through reduced rate increases, prior to the end of the phase-in plan in 1996-7 adopted in Resolution R-86-112. Our order, in effect, adjusts the increases in the Company's electric rates and charges specified in Resolution R-86-112. This is, in our view, within the Council's reservation of right to conduct this inquiry into the prudence of NOPSI's involvement in Grand Gulf and issue orders with respect thereto.

NOPSI's rate increases reflected in Paragraphs 4 and 5 of Resolution R-86-112 shall, in effect, be adjusted as follows, to reflect the $135 million disallowance ordered here. For bills rendered on and after April 9th of each of the following years, NOPSI shall be allowed to increase its base rates on an annual basis by the following additional amounts:

1988 - $16.6 million;
1989 - $17.3 million; and,
1990 - $18.1 million.

For bills rendered on an after April 9th of years subsequent to 1990, NOPSI shall be entitled to increase its base electric rates by 4.5% of $420.7 million compounded annually until: (a) Grand Gulf I costs are being fully recovered on a current basis, and (b) the amounts previously deferred, less $135 million of disallowance, have been fully recovered.

NOPSI shall reflect the disallowance by reducing the amount of deferred Grand Gulf I expense to be collected in future years by $135 million. The reserve for deferred taxes applicable to the deferred Grand Gulf I expenses

shall also be adjusted to reflect the appropriate tax effects of the disallowance. NOPSI shall not be permitted to recover from ratepayers any carrying charges on the $135 million reduction, from the date of the disallowance forward.

The remedy ordered by the Council shall be a one-time disallowance and adjustment. With this remedy, the prudence inquiry of NOPSI's management vis-a-vis Grand Gulf I is terminated, and no further amount of disallowance shall be considered in the future.

Moreover, in order to ensure that the economic effects of the disallowance are in harmony with the expert testimony here, the Council recognizes its responsibility to act in a timely fashion to meet NOPSI's legitimate needs in the future for rate relief based on increased costs and similar grounds.

Our order here today does not prejudice or affect in any way pending litigation pertaining to Grand Gulf, including the City's abrogation lawsuit against NOPSI, litigation before the United States courts in the 5th Circuit and the District of Columbia Circuit, and proceedings before the Federal Energy Regulatory Commission.

The evidence here regarding decision-making by NOPSI's management also leads us to conclude that there is need for some form of regulatory review of substantial, long-term commitments into which the company proposes to enter before such commitment is undertaken. Alternatively, substantial commitments could be conditioned upon specific approval by the Council.

There are presently statutory provisions requiring certification by the Council of a plan by NOPSI to begin construction of any new physical plant, or to extend or add to any existing plant, if the cost exceeds two percent of the company's rate base at the time of such construction, extension or addition. LSA-R.S. 33-4406. The Council must

certify that the public convenience and necessity require the proposed construction, extension or addition of physical facilities, and the Council is the sole and final judge of what the public convenience and necessity require, in every instance. (*Id.*) No such certification was ever requested by NOPSI for its Grand Gulf commitment because, the company argues, its commitment is a purchase of power that falls beyond the scope of LSA-R.S. 33-4406 (*i.e.*, its purchase of Grand Gulf power does not constitute construction, extension or addition of any physical plant, equipment, property or facility as covered by the certification requirement).

Although this issue is now being litigated in a lawsuit in Louisiana state courts, it is important for this Council to consider the adoption of a requirement, by resolution or ordinance, that requires NOPSI to seek certification by the Council of any purchase commitment in the future, which, when viewed in its entirety, represents a significant potential impact on NOPSI and its customers, in excess of, say, two percent of its then-current rate base.

It is the Council's intention to consider the promulgation of a certification or approval requirement for the company's purchase commitments in a separate docket to be initiated following the issuance of this order. All parties and the public will have the opportunity to make their positions on such a proposal known to the Council at that time.

The foregoing findings are determinations having been reviewed by the Council, the roll was called, and the result was as follows:

Yeas:

Nays:

The foregoing findings and determinations are adopted.

APPENDIX A

JOHN B. FARMAKIDES
Attorney At Law
5835 Upton Street
McLean, Virginia 22101
(703) 241-0006

May 21, 1986

The Honorable Joseph I. Giarrusso
Council President
News Orleans City Council
1300 Perdido Street
New Orleans, LA 70112

Re: Matter of Ex-Parte Application of New Orleans Public Service, Inc. for Increase in Electric Rates. Doc. No. CD-85-1

Dear Mr. Giarrusso:

This is to advise the City Council that the record of the above captioned proceeding was closed by agreement of the parties and the Hearing Officer on May 7, 1986.

Pursuant to City Council direction, the hearings called for this proceeding were held, as duly noticed, on March 4, 5 and 7, and on April 8, 9, 10, 11 and 14, 1986. During these eight days of hearing, some 116 Exhibits were introduced into the record, and direct testimony or depositions, obtained from 33 witnesses, were incorporated as part of approximately 2,400 pages of transcript. Following completion of the hearings the parties were offered an opportunity to correct the transcripts and the hearing record index.

The record includes all the exhibits, testimony, letters and documents admitted, transcripts developed, and the procedural Resolutions, Ordinances and other regulations

referenced. The original and one copy of the record is in the custody of Ms. Emma Williams, Clerk of the City Council. An index, which may also serve as a log of the record, has been prepared and is submitted herewith. Also submitted for your convenience, is a copy of the May 7 memorandum closing the record.

In my opinion, the hearings proceeded in an orderly manner, and an adequate record was developed in accordance with the requirements of the City Council. The record is hereby delivered to the City Council.

Yours truly,

/s/ John B. Farmakides
Hearing officer

Hon. J.I. Giarrusso
Ltr. May 21, 1986

cc: All Councilmen
Okla Jones, II, Esq.
Thomas Milliner, Esq.
Jon Eckert, Esq.
Brod Bagert, Esq.
Clint Vince, Esq.
Glen Ortman, Esq.
Beverly Zervigon, Esq.
Bruce Naccari, Esq.
Mr. Gary Groesch
Mr. Jose Cierra
Bernhardt Wruble, Esq.
Herschel Abbott, Jr., Esq.
Thomas Lind, Esq.
Emma Williams, City Clerk

Before the
City Council of New Orleans

Matter of Ex Parte Application of New Orleans Public Service, Inc. for an Increase of its Electric Rates. Docket No. CD-85-1

Memorandum for the Record: May 7, 1986

By telephone conference call on this date among Bernhardt Wruble, for the City Council, Herschel Abbott, Jr., for New Orleans Public Service, Inc. (NOPSI), Gary Groesch, for Citizens for Safe Energy, and with Jon Eckert and Kelly Meehan of the City Council research staff, the Hearing Officer convened a meeting of the parties. The matters discussed and actions taken were as follows:

1. The Hearing Officer noted the decision of the City Council in response to the issue he had raised concerning the proffer of the testimony of George E. White, Jr. on behalf of NOPSI. That decision was contained in two letters of the City Council, dated April 22, and April 30, 1986, wherein the City Council outlined a schedule of events and actions to be taken.

2. Also noted were the letters of NOPSI in response to the City Council, dated April 28, and May 2, 1986, contending that the schedule and conditions set for the receipt of the proferred testimony amounted to a denial of procedural due process and were not acceptable. (The name of Jon Eckert in the letter of May 2 was corrected to read Kelly Meehan.)

3. In view of the referenced documents in items #1 and #2, above, and the ensuing discusion, the Hearing Officer concluded that no further hearings were in order, and, accordingly, with the agreement of the parties, the record was closed.

4. It was also agreed that any transcript corrections to be offered by any party shall first be transmitted to the

other two parties with copy to the Hearing Officer. In order to complete this item, any such proposal shall be accomplished within 5 days. Any objections to such proposed corrections shall be made within 3 days of receipt, with copy to the Hearing Officer. That Officer will address the proposal, and any related objection, and make an appropriate determination for the record.

5. A copy of the record to be certified to the City Council will be transmitted by the Hearing Officer to the parties in draft form as soon as possible. Any proposed correction, amendment, etc., by any party, shall be transmitted to the Hearing Officer within 5 days, with simultaneous copy to the other two parties. The Hearing Officer will resolve any disagreement and certify the final record.

6. No other matter having been presented, the record was closed as noted and the telephone conference was concluded at 4:10 p.m., April 7, 1986.

/s/ John B. Farmakides
John B. Farmakides
Hearing Officer

Before the
City Council of New Orleans

Matter of Ex Parte Application of New Orleans Public Service, Inc. for an Increase of Its Electric Rates. Doc. No. CD-85-1

The official RECORD of the above captioned matter, compiled as of May 7, 1986, is set forth below in items 1 through 135 as follows:

A. Application, and Procedural Documents

1. Application for permanent rate relief, as filed by New Orleans Public Service Inc., on May 17, 1985, and resubmitted on Sep. 30, 1985 and Oct. 11, 1985.
2. Rules of Practice and Procedure, Ordinance No. 828 MCS (As amended) Art. VI, Sec. 52-100 *et.seq.*,
3. Referenced Resolutions of the City Council: R-85-636, Oct 10, '85; R-85-741, Dec 2, '85; R-86-43, Feb 6, '86; R-86-52, Feb 6, '86;
4. Referenced Letters of the City Council: S. Barthelemy to J. Cain dated Jan. 29, 1986; S. Barthelemy to J. Cain dated Feb. 14, 1986; S. Barthelemy to J. Cain dated Mar. 26, 1986
5. Certification of motion to City Council by Hearing Officer, dated April 14, 1986, and his Memorandum for the Record, dated May 7, 1986.
6. Determination by City Council on motion submitted, with Notices for continued proceedings, dated April 22, and April 30, 1986.

B. Exhibits: New Orleans Public Service, Inc.

7. NOPSI-Cunningham Ex. 1A
   Original testimony of S G Cunningham filed on May 17, 1985 — Mar.4:Tr.33
8. NOPSI-Cunningham Ex. 1B
   Additional testimony, Feb. 5, 1986 — Tr.33

9. NOPSI-Cunningham Ex. 1C
   Rebuttal testimony, Feb. 26, 1986 — Tr.33
10. NOPSI-McCletchie Ex. 2A
    Original testimony filed May 17, 1985 — Tr.83
11. NOPSI-McCletchie Ex. 2-B
    Additional testimony, Feb. 5, 1986 — Tr.83
12. NOPSI-McCletchie Ex. 2-C
    Rebuttal testimony, Feb. 26, 1986 — Tr.83
13. NOPSI-Randall Ex. 3
    Original testimony filed May 17, 1985 — Tr.119
14. NOPSI-Abadie Ex. 4-A
    Original testimony filed May 17, 1986 — Tr.122
15. NOPSI-Abadie Ex. 4-B
    Rebuttal testimony filed Feb 26, 1986 — Tr.122
16. NOPSI-Quivey Ex. 5
    Rebuttal testimony filed Feb. 26, 1986 — Tr. 135
17. NOPSI-Triech Ex. 6
    Original testimony filed May 17, 1985 — Tr. 168
18. NOPSI-Cain Ex. 7-A
    Original testimony filed May 17, 1985 — Tr. 172
19. NOPSI-Cain Ex. 7-B
    Additional testimony filed Feb. 5, 1986 — Tr. 172
20. NOPSI-Cuthbert Ex. 8
    Pg. 1 of 4 of Exhibit R.W.C.-5 — Mar.5:Tr.49
21. NOPSI-Cuthbert Ex. 9
    FERC Opinion #234 rendered June 13, 1985 — Tr.73
22. NOPSI-Cecil Ex. 10
    Copy prepared direct testimony before L.P.S.C. Docket #U-15689 — Tr.168
23. NOPSI-Cecil Ex. 11
    Test year revenue from testimony in L.P.S.C. Docket #U-15689 — Tr.174
24. NOPSI-Treich Ex.12
    From E.A. Cecil's Response to NOPSI Request Question #6, table 1 — Tr.222
25. NOPSI-Cecil Ex.13
    Work papers produced by E.A. Cecil in response

to Data Request Question #6, dated Feb. 27, 1986 Tr.231
26. NOPSI-Cunningham Ex.-14
White Bluff Capacity & Reserve Equalization Payments listing Mar.7:Tr.7
27. NOPSI-Cunningham Ex.-15
MSU Systems Capability listing Tr.12
28. NOPSI-Jones Ex.-16
Rebuttal testimony Tr.34
29. NOPSI-Haneberg Ex.-17
Rebuttal testimony Tr.92
30. NOPSI-Phillips Ex.-18A
Prefiled testimony, 5/17/85 Tr.113
31. NOPSI-Phillips Ex.-18B
Prefiled testimony, 2/26/86 Tr.113
32. NOPSI-Phillips Ex.-19
Computation of margin of earnings of 12/85 Tr.161
33. NOPSI-Phillips Ex.-20
Computation of margin of earnings of 1/86 Tr.162
34. NOPSI-Palast Ex.-21
Comparison of NOPSI rates Tr.203
35. NOPSI-Palast Ex.-22
Rate comparison of 4/84 and 1/86 Tr.206
36. NOPSI-Palast Ex.-23
Work papers: input-output model Tr.225
37. NOPSI-Palast Ex.-24
Input-output model computer printout Tr.235
38. NOPSI-Clemente Ex.-25
Written Clemente testimony Tr.281
39. NOPSI-Ex.26
Letter to Clerk of Council L. Siegel, 12/16/85 Tr.404
40. NOPSI-Ex.27
Attachment to Ltr of 12/16/85 (Memorandum) Tr.404

41. NOPSI-Ex.28
Attachement to Ltr of 12/16/85 (Statement of Objections) Tr.404
42. NOPSI-Ex.29
Letter of 2/14/86 to James M. Cain Tr.404
43. NOPSI-Ex.30
Letter of 3/14/86 to Mr. Wruble Tr.405
44. NOPSI-Ex.31
Letter of 3/18/86 to Mr. Cain Tr.405
45. NOPSI-Ex.32
Letter of 3/24/86 Tr.405
46. NOPSI-Ex.33
Letter of 3/26/86 to Hon. Emma Williams Tr.405
47. NOPSI-Ex.34
Letter of 3/24/86 to Mr. James Cain Tr.405
48. NOPSI-Cain Ex.35
Prefiled testimony James M. Cain Tr.467
49. NOPSI-Hurstell Ex.36
Testimony 12/16/85 Tr.575
50. NOPSI-Hurstell Ex.37
Rebuttal testimony 3/31/86 Tr.576
51. NOPSI-Lundberg Ex.38
Deposition Tr.827
52. NOPSI-Trumps Ex.39
Pre-filed direct testimony Tr.857
53. NOPSI-Ex.40
Pre-filed rebuttal testimony Tr.857
54. NOPSI-Ex.41
Exhibits 1,2 and 3 Tr.857
55. NOPSI-Ex.42
1979 Annual Report-Middle South Utilities ** Tr.861
56. NOPSI-Louiselle Ex.43
Prefiled testimony Tr.1095
57. NOPSI-Hendrie Ex.44
Rebuttal testimony Tr.1252
58. NOPSI-Pearl Ex.45
Direct testimony 12/16/85 Tr.1349

59. NOPSI-Ex.46
Rebuttal testimony 3/31/86 Tr.1353
60. NOPSI-Ex.47
FERC brief Docket #85-3654 Tr.1435
61. NOPSI-Ex.48
Letter from Councilman Giarrusso to Mr. Sexton 1/13/86 Tr.1448
62. NOPSI-Ex.49
Letter to Councilman Giarrusso from P.G. Wright 4/3/86 Tr.1448
63. NOPSI-Komanoff Ex.50
Read, signed & corrected deposition Tr.1494
64. NOPSI-Hurstell Ex.51
Speech in New Orleans, La. Tr.1604
65. NOPSI-Komanoff Ex.52
Testimony before the Subcommittee on Energy & Environment 7/12/79 ** Tr.1683
66. NOPSI-McWhinney Ex.53
Prefiled testimony Tr.1705
67. NOPSI-McLetchie Ex.54
Deposition dated 3/31/86 Tr.1916
68. NOPSI-Palast Ex.55
Deposition dated 3/3/86 Tr.1916
69. NOPSI-Proffer of White testimony
To be submitted on latter date Tr.1918

C. Exhibits: City of New Orleans

70. CNO-Ex.-1
Second data request to NOPSI #CNO-2-6 Mar.4:Tr.60
71. CNO-Ex.-2
White Bluff & reserve equalization payments July '85 through Feb. '86 Tr.74
72. CNO-Ex.-3
Filing by AP&L with S.E.C. Jan. 24, 1986 Tr.97
73. CNO-Ex.-4
AP&L settlement Sept. 5, 1985 Tr.98

74. CNO-Ex.-5
Work papers of R.J. Abadie Tr.129
75. CNO-Ex.-6
Excerpt Electric Light & Power, Feb. '86, Vol. 64, No. 2 Tr.153
76. CNO-Ex.6-A
Prepared direct testimony of R.W. Cuthbert Mar.5:Tr.15
77. CNO-Ex.6-B
(RWC-1) Record of Testimony & Regulatory Experience Tr.15
78. CNO-Ex.6-C
(RWC-2) Cost of Capital Data Tr.15
79. CNO-Ex.6-D
(RWC-3) Financial Data for MSU & Comparable Electric Utilities Tr.15
80. CNO-Ex.6-E
(RWC-4) MSU's Cost of Equity Capital Tr.16
81. CNO-Ex.6-F
(RWC-5) Financial data for NOPSI & MNU Operating Cos. Tr.16
82. CNO-Ex.6-G
(RWC-6) NOPSI's Capitalization & Weighted Cost of Capital Tr.16
83. CNO-Ex.7-A
Prepared direct testimony of E.A. Cecil Tr.112
84. CNO-Ex.7-B
Exhibits to direct testimony of E.A. Cecil Tr.112
85. CNO-Ex.7-C
Preliminary Analysis of Settlement Proposal of Testimony & Exhibits of NOPSI filed Feb. 5, 1986 Tr.112
86. CNO-Ex.7-D
Corrected exhibit of E.A. Cecil previously marked 7-B Tr.128
87. CNO-Ex.-8
Prepared direct testimony of R.F. Camus Tr.197

88. CNO-Ex.-9
Request for production of data & documents of R.F. Camus on behalf of City of New Orleans — Tr.217

89. CNO-Ex.10
Order on rehearing numbered U-15689-A — Mar.7:Tr.117

90. CNO-Ex.11
Order Number U-16092-A — Mar.7:Tr.119

91. CNO-Ex.12
Solomon Bros. report of 1/6/86 — Tr.138

92. CNO-Ex.-13
Balance sheet of 12/31/84 — Tr.150

93. CNO-Ex.-14
Balance sheet of 6/30/85 — Tr.150

94. CNO-Ex.-15
Prefiled testimony of G.A. Palast — Tr.168

95. CNO-Ex.-16
Deposition of Mr. Carter — Tr.413

96. CNO-Ex.-17
Deposition of Mr. Jung — Tr.413

97. CNO-Ex.-18
Deposition of Mr. Brodtmann — Tr.413

98. CNO-Ex.-19
Deposition of Mr. Duncan — Tr.413

99. CNO-Ex.-20
Deposition of Mr. Krebs — Tr.413

100. CNO-Ex.-21
Deposition of Mr. Teamer — Tr.413

101. CNO-Ex.-22
Deposition of Mr. Trumps — Tr.413

102. CNO-Ex.-23
Deposition of Mr. Smallpage — Tr.413

103. CNO-Ex.-24
Deposition of Mr. McLetchie — Tr.413

104. CNO-Ex.-25
Deposition of Mr. Chavanne — Tr.413

105. CNO-Ex.-26
Deposition of Mr. Talbot — Tr.414

106. CNO-Ex.-27
Deposition of Mr. Wyatt — TR.414

107. CNO-Ex.-28
Deposition of Mr. Cain — Tr.414

108. CNO-Ex.-29
Deposition of Mr. Hurstell — **Tr.414

109. CNO-Ex.-30
System Agreement Filing ER82483000 — TR.430

110. CNO-Ex.-30(a)
MLH Exhibit 5A — Tr.437

111. CNO-Ex.-30(b)
Memorandum from E.A. Louberger — Tr.520

112. CNO-Ex.-30(c)
James M. Cain LPSC testimony — Tr.541

113. CNO-Ex.-31
Testimony J. Lundberg 3/19/86 — Tr.826

114. CNO-Ex.-32
Ltr. Congressman Markety 3/4/86 — Tr.1155

115. CNO-Ex.-33
Testimony B.M. Louiselle 12/7/83 in Docket Nos. U15684 & U15689. Pages 749-822 & 846-875 — Tr.1177

116. CNO-Ex.-34
Cover page & Pages 7&8 of 1978 Licensing, Design & Construction Problems report — Tr.1305

117. CNO-Ex.-35
Testimony J.M. Hendrie before New Hampshire Utilities Commission — Tr.1305

118. CNO-Ex.-36
Response to counsel data request PD-11 — Tr.1359

119. CNO-Ex.-37
Response to counsel date request PD-13 — Tr.1387

120. CNO-Ex.-38
C. Komanoff prefiled testimony & attachments — Tr.1460

121. CNO-Ex.-39
Book *Power Plant Cost Escalation* by C. Komanoff published 1981 ** Tr.1566
122. CNO-Ex.-40
Compilations of Council, CNO dated 3/19/86 Tr.1696
123. CNO-Ex.-41
Mooz report Tr.1809
124. CNO-Ex.-42
NOPSI Board of Directors minutes: 9/72-present Tr.1908
125. CNO-Ex.-43
Deposition of J. Cain in Civil Action #85-5273 Tr.1909
126. CNO-Ex.-44
Deposition of E. Lupberger in Civil Action #85-5273 Tr.1909
127. CNO-Ex.-45
Deposition of G. Palast; dtd: March, 1986 Tr.1910

D. Transcripts

128. Tuesday, March 4, 1986. Pages 1-194
129. Wednesday, March 5, 1986. Pages 1-261
130. Friday, March 7, 1986. Pages 1-371
131. Tuesday, April 8, 1986. Pages 372-730
132. Wednesday, April 9, 1986. Pages 731-1246
133. Thursday, April 10, 1986. Pages 1247-1436
134. Friday, April 11, 1986. Pages 1437-1700
135. Monday, April 14, 1986. Pages 1701-1924 and Pages 1-45

**1. Note: Exhibits identified in items 38, 55, 65, 108 and 121 were admitted with restrictions as set forth in the appropriate pages of the transcript.

2. Note: Transcript pages are numbered on a daily basis for March 4 and 5, and thereafter, consecutively commencing on Friday, March 7, 1986, except for new pages 1-45 as prepared for Monday, April 14, 1986.

I hereby certify that items 1 through 135 set forth above were adduced and compiled in the above captioned matter.

/s/ John B. Farmakides
John B. Farmakides
Hearing Officer

JOHN B. FARMAKIDES
Attorney At Law
5835 Upton Street
McLean, Virginia 22101
(703) 241-0006

May 8, 1986

Herschel L. Abbott, Jr., Esq.
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Mr. Gary L. Groesch
Citizens for Safe Energy
P.O. Box 791169
New Orleans, Louisiana 70179-1169

Gentlemen:

Transmitted herewith is a copy of a memorandum for the record setting forth the matters discussed and actions taken during the telephone conference held on May 7, 1986.

Also please find a draft copy of an index of those items that will constitute the record in this proceeding. Please review the same and advise me, within 5 days, of any suggested corrections, amendments, etc. I will prepare and certify the final record as soon as possible thereafter.

Thank you for your cooperation.

Sincerely,

/s/ John B. Farmakides
John B. Farmakides

Encls.

APPENDIX B

John B. Farmakides
Attorney at Law
5835 Upton Street
McLean, Virginia 22101
(703) 241-0006

April 16, 1987

Honorable Joseph I. Giarrusso
Council President
New Orleans City Council
1300 Perdido Street
New Orleans, LA 70112

Re: Ex Parte Application of New Orleans Public Service Inc. for increase in Electric Rates, Docket No. CD-85-1

Dear Mr. Giarrusso:

This is to advise the City Council that the record has been completed in the above captioned matter to include, by direction of the City Council, the "remedy phase" of the said application.

The hearings were held in accordance with the schedule set by the Council. Thereafter, the parties were provided with reasonable time after receiving the final transcripts to review the same, submit any necessary corrections thereto, and file briefs. The Hearing Officer received a copy of the transcript for the final day of hearing on April 4, 1987.

A joint telephone conference with the parties was held on April 10, 1987, to discuss certain outstanding matters related to this proceeding as well as to the bond financing phase of the application. During that conference, the final record of this matter was closed as of April 10, 1987.

The attached certified index of the "remedy phase" to be included as part of the official record of the above captioned matter is hereby delivered to the City Council. It should be noted that the complete official record index of Docket No. CD-85-1 is composed of four segments, identified and forwarded by separate letters dated: May 6, 1986, February 12, 1987, April 10, 1987, and April 16, 1987. All four segments and all materials developed and compiled during the hearings have been delivered to the custody of the Clerk of the City Council.

Yours truly,
/s/ John B. Farmakides
Hearing Officer

Encl. as stated.

Before the
City Council of New Orleans

Matter of Ex Parte Application of New Orleans Public Service, Inc. for an Increase of Its Electric Rates. Doc. no. CD-85-1

The official *RECORD* of the above captioned matter, initially compiled as of May 7, 1986, is further augmented by Order of the City Council to include additional evidentiary material as set forth in items 1 through 67 below compiled as of April 10, 1987, as follows:

A. Application, and Procedural Documents

1. All materials previously included in the official record dated May 7, 1986.
2. All relevant Orders of the City Council, including those dated: May 20, 1986, July 7, 1986, July 30, 1986, August 29, 1986, December 2, 1986, and February 10, 1987.
3. Petition to intervene by the Attorney General of Louisiana dated October 22, 1986; approved by Res. R-87-10 of the City Council.
4. All materials previously included in the official record relating to the Tax Act Inquiry phase and the Financing Application phase of this Docket, submitted by letter dated February 12, 1987, and by letter dated April 10, 1987, respectively.,

B. Exhibits: New Orleans Public Service, Inc.

5. NOPSI-Excerpts City Council Hearing Ex.57 Tr.2195
6. NOPSI-Present Value Work Table Ex.58 (Grand Gulf Fuel Savings) Tr.2195
7. NOPSI-Excerpts City Council Hearing Ex.59 Tr.2197

8. NOPSI-G. Palast Ex.60 Deposition Tr.2315
9. NOPSI-G. Palast Ex.61 Response to data request from NOPSI Tr.2352
10. NOPSI-G. Palast Ex.62 Deposition Tr.2417
11. NOPSI-Eisenberg Ex.63 Deposition Tr.2465
12. NOPSI-A. Brimmer Ex.64 Pre-filed testimony Tr.2484
13. NOPSI-Barach Ex.65 Deposition-Oct. 17, 1986 Tr.2531
14. NOPSI-Hahne Ex.66 Rebuttal testimony Tr.2539
15. NOPSI-R.W. Jones Ex.67 Rebuttal testimony Tr.2704
16. NOPSI-R.W. Jones Ex.68 Deposition Tr.2704
17. NOPSI-Cunningham Ex.69 Rebuttal testimony Tr.2765
18. NOPSI-Cunningham Ex.70 Deposition Tr.2779
19. NOPSI-Mc Letchie Ex.71 Rebuttal Testimony Tr.2844
20. NOPSI-Mc Letchie Ex.72 Deposition Volume I Tr.2845
21. NOPSI-Mc Letchie Ex.73 Deposition Volume II Tr.2845
22. NOPSI-Mc Letchie Ex.74 Testimony Tr.2854

23. NOPSI-Palast Ex.74A
Letter to M. Caruso from G. Palast Tr.2852

24. NOPSI-Financial Model Run Ex.75
Run 10-B Tr.2871

25. NOPSI-Financial Model Run Ex.76
Run 10-C New Tax Law Tr.2894

26. NOPSI-NOPSI Ex.77
Response to City's Data Request #13 Tr.2899

27. NOPSI-Louiselle Ex.78
Rebuttal testimony Tr.3008

28. NOPSI-Louiselle Ex.79
Deposition Oct. 20, '86 Tr.3008

29. NOPSI-Louiselle Ex.79A
Errata Sheet Tr.3008

30. NOPSI-Haneberg Ex.80
Pre-filed testimony Tr.3035

31. NOPSI-Haneberg Ex.81
Deposition 10/20/86 Tr.3035

32. NOPSI-Haneberg Ex.82
Supplemental testimony data request Tr.3054

33. NOPSI-Marked Ex.83
Spread Sheet Tr.3108

34. NOPSI-Marked Ex.84
Louisiana Public Service Commission
Order #15689 Tr.3108

35. NOPSI-Mc Letchie Ex.85
Supplemental rebuttal testimony Tr.3133

36. NOPSI-Mc Letchie Ex.86
Deposition with attached exhibits Tr.3134

C. Exhibits: City Council

37. CNO-NOPSI Computer Run Ex.46
Computer Run 10-B Preferred Dividends Tr.1998

38. CNO-Cecil Ex.47
Deposition Tr.1998

39. CNO-Haneberg Ex.48
Testimony Tr.2220

40. CNO-Palast Ex.49
Testimony & exhibits Sept. 1986 Tr.2308

41. CNO-Palast Ex.50
Rebuttal testimony Oct. 1986 Tr.2308

42. CNO-Palast Ex.51
Deposition (see NOPSI EX. 60) Tr.2322

43. CNO-Palast Ex.52
Computer run Tr.2884

44. CNO-Hahne Ex.53
Deposition Tr.2544

45. CNO-DeLoitte Haskins & Sells Ex.55
(Unqualified) Auditors opinion Tr.2632

46. CNO-DeLoitte Haskins & Sells Ex.55
Inter-office memo Dated April 23, 1986 Tr.2632

47. CNO-H. Abbott Ex.56
Letter April 18, 1986 Tr.2632

48. CNO-NOPSI Ex.57
Excerpt 1985 Annual Report
DHS Opinion 3-14-86 Tr.2632

49. CNO-GAAS Guide Ex.58
Pages 8.49 & 8.50 Tr.2632

50. CNO-NOPSI Ex.59
Excerpts from SEC Form 10Q
for qt. ending 3/31/86 Tr.2662

51. CNO-NOPSI Ex.60
Excerpts from SEC Form 10Q for qt. ending 6/30/86 — Tr.2662

52. CNO-NOPSI Ex.61
Forms U-1, filed 9/23/86 — Tr.2662

53. CNO-McLetchie Ex.62
Work papers — Tr.2979

54. CNO-McLetchie Ex.63
Work papers — Tr.2979

55. CNO-Palast Ex.64
Errata sheet of deposition — Tr.3003

56. CNO-G. Palast Ex.65
Pre-filed testimony — Tr.3249

57. CNO-G. Palast Ex.65A
Work papers — Tr.3249

58. CNO-G. Palast Ex.66
Deposition Feb. 20, 1987 — Tr.3253

59. CNO-G. Palast Ex.67
Computer financial analysis — Tr.3267

60. CNO-E.Cecil Ex.68
Pre-filed testimony — Tr.3342

D. Exhibits: Citizens for Safe Energy (Intervenor)

61. SAFE-Eisengerg Ex.3 (see footnote 2)
Pre-filed testimony & exhibits — Tr.2438

62. SAFE-Barach Ex.4
Pre-filed rebuttal testimony Oct. 10, 1986 — Tr.2522

E. Transcripts

63. Tuesday, October 21, 1986. Pages 1927 - 2226 and

Pages 1 - 23

64. Wednesday, October 22, 1986. Pages 2227 - 2557

65. Thursday, October 23, 1986. Pages 2558 - 2878

66. Friday, October 24, 1986. Pages 2879 - 3120

67. Tuesday, February 24, 1987. Pages 3121 - 3420

F. Footnotes

Note #1. By agreement of the parties and the Hearing Officer, made during a joint telephone conference call on April 10, 1987, the final evidentiary record in the above captioned matter was closed as of that day, April 10, 1987, except as to certain matters related to the financing application phase of this proceeding. Those matters are noted in the separate record index of that phase submitted earlier by letter dated April 10, 1987.

Note #2. Exhibits No.#1 and No.#2 by the party Citizens for Safe Energy were marked but not offered or admitted into the record.

Note #3. The Attorney General for the State of Louisiana, admitted as a party Intervenor in the proceeding, did not present testimony or file exhibits to the record, but indicated an intention to file a post hearing brief. Such a brief was filed jointly with the other Intervenor, Citizens for Safe Energy.

Note #4. Docket No. CD-85-1 includes all evidentiary material relating to the Prudence and Remedy aspects of the inquiry, as well as to the Tax Act Inquiry phase and the Financing Application phase. For convenience, and by agreement of the parties, the last two phases were separately compiled and indexed.

I hereby certify that items 1 through 67 set forth above were adduced and compiled in the above captioned matter.

/s/ John B. Farmakides
John B. Farmakides
Hearing Officer

cc.: All Council Members
Ms Emma Williams (Clerk of Council)
Brod Bagert, Esq.
Joseph Bernstein, Esq.
Mr. Gary L Groesch
Okla Jones III, Esq.
Thomas O Lind, Esq.
Mr. Kelly Meehan
Bruce Naccari, Esq.
Glen L Ortman, Esq.
Prof. Richard Pierce, Jr.
Warren M Schultz, Jr. Esq.
Mr. Jose Sierra
Alan C Wolf, Esq.
Bernhardt K Wruble, Esq.
Beverly Zervignon, Esq.

APPENDIX C

WITNESSES AND KEY INDIVIDUALS

Jeffrey A. Barach

Mr. Barach is a professor of Management at Tulane University. He began teaching at the University as an Assistant Professor in 1965, was an Associate Professor from 1968 to the end of 1985, and has been a full professor since that time. Mr. Barach's principal areas of concentration are: Business Policy; Business, Social and Individual Values; and Marketing, Advertising, Consumer Behavior, and Mass Communications. He has also held positions concurrent with his University post with several management consulting firms. Mr. Barach holds an A.B. from Harvard College and an M.B.A. and D.B.A. from the Harvard University Graduate School of Business Administration.

Andrew F. Brimmer

Mr. Brimmer is President of Brimmer and Company, Inc., an economic and financial consulting firm based in Washington. Mr. Brimmer holds a Ph.D. in economics from Harvard and has held various academic positions. Mr. Brimmer entered the government in 1963 as Deputy Assistant Secretary for Economic Policy Review for the U.S. Department of Commerce, he was later appointed by President Johnson to the position of Assistant Secretary for Economic Affairs. In 1966, he was appointed as a Member to the Board of Governors of the Federal Reserve Board. He left that position in 1974 and served as a Visiting Professor for two years in the Graduate School of Business Administration at Harvard University.

August J. Brodtmann

Mr. Brodtmann was employed by NOPSI from 1936 until his retirement in 1980. During his years at NOPSI, he

served in various capacities such as Assistant to General Auditor, Manager of property accounting, Assistant to Financial Vice President of NOPSI, Comptroller of NOPSI and Vice President of Finance of NOPSI. In addition, he served on the Middle South Finance Committee.

James M. Cain

Mr. Cain is presently President and Chief Executive Officer of both NOPSI (since 1978) and LP&L (since 1982). Beginning in 1978, Mr. Cain has served on the MSU, MSE, MSS and NOPSI Boards of Directors. Mr. Cain has been an employee of the Middle South System since 1960 when he started as a research assistant with NOPSI. He progressed through various jobs in NOPSI's Personnel Department, served as Vice President of personnel and Vice President of Administration. He then moved to MSS where he served as Executive Vice President and President from January 1975 to April 1978 before returning to NOPSI as president. Mr. Cain has both a Bachelor's and Master's Degree in Business Administration.

Fr. James C. Carter

Fr. Carter has been a member of the NOPSI Board of Directors since 1983. He is a Roman Catholic Priest and President of the Loyola University in New Orleans.

John H. Chavanne

Mr. Chavanne was employed by NOPSI from April 1966 until March 1985. He held various positions in the Methods & Procedures Department, was manager of the Budget & Statistical Department, served as Assistant Vice President of Finance, and Comptroller of NOPSI. In addition, Mr. Chavanne served as Vice President of Finance and Treasurer of NOPSI from November 1980 until consolidation of NOPSI and LP&L management. At that time he became Vice President of Corporate Control and Assistant Secretary of both NOPSI and LP&L. From November 1980 through November 1984, Mr. Chavanne regularly attended NOPSI Board meetings. He also served on Middle South System Finance Committee, Pension Plan Committee and Customer Information System Committee. Mr. Chavanne received his B.B.A., M.B.A. and J.D. from Loyola University in New Orleans. He is also a Certified Public Accountant.

Edward A. Cecil

Mr. Cecil is a partner in R.W. Beck and Associates, Engineers and Consultants, a national firm of engineers and consultants which provides services in areas such as design and construction engineering, environmental studies, power supply, power pooling, management systems, feasibility studies, systems engineering, and computer services. The firm has significant experience in the public utility field. Mr. Cecil has substantial experience in public utility matters, including rates, natural gas curtailment, power supply and resource planning and economic analyses. Mr. Cecil conducts a course on Electric Utility Retail Rate Design for the American Public Power Association. He has testified before a number of Federal and state regulatory commissions and courts. Mr. Cecil holds an A.B. and M.A. degrees from Colorado State University in Civil Engineering.

Shelton G. Cunningham

Mr. Cunningham became Senior Vice President for Marketing and Rates with Louisiana Power & Light Company (LP&L) and NOPSI in 1986. He began with LP&L in 1966 as a sales representative. In 1968 he became a rate analyst, was promoted to Rate Administration Manager in 1972, Assistant Director of Rates and Research in 1976 and Director in 1979. Mr. Cunningham was elected Vice President of Rates and Research in 1982 and supervised the functional consolidation of the Rate Departments of

LP&L and NOPSI. Mr. Cunningham holds a B.S. degree in Mechanical Engineering from Mississippi State University and is a registered Professional Engineer in Louisiana.

Brooke Duncan

Mr. Duncan has served on the NOPSI Board of Directors since 1967. He also serves on the MSU Board of Directors. Mr. Duncan is the owner of a local awning manufacturing company and a wholesale hardware distribution company.

Theodore Eisenberg

Mr. Eisenberg is a Professor of Law at Cornell University who has taught a variety of courses including Debtor-Creditor Law, Civil Rights Legislation, Corporate Taxation and Individual Taxation. Mr. Eisenberg has been a professor since 1977 when he began teaching at UCLA. He has participated in the University of San Diego's summer program at Oxford, and as a Visiting Professor of Law at Harvard Law School.

Robert L. Hahne

Mr. Hahne is a certified public account and Partner in the firm of Deloitte Haskins & Sells (DH&S), a public accounting firm, and is responsible for their public utility industry practice. His duties at DH&S include coordination of the public utility audit, tax, and consulting efforts of the Firm's approximately 100 offices. Mr. Hahne is co-author of *Accounting for Public Utilities*. He has appeared as an expert witness in court, the Federal Energy Regulatory Commission, and numerous state regulatory commissions. Mr. Hahne holds a B.A. in Economics and Business Administration from Central Methodist College.

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Joseph M. Hendrie

Dr. Hendrie is presently engaged in a private consulting engineering practice which provides services for private institutions and government agencies. He received his B.S. in physics from Case Institute of Technology and his PhD. in physics from Columbia University. He has worked at the Brookhaven National Laboratory where he performed research on nuclear power reactors, served as head of the Engineering Division, Department of Applied Science; Chairman, Department of Applied Science; Senior Scientist and Special Assistant to the Director. Dr. Hendrie served as Chairman of the Advisory Committee on Reactor Safeguards and Deputy Director, Technical Review of the Atomic Energy Commission, Directorate of Licensing. From August 1977 to June 1981 he served as Chairman, then Commissioner, then Chairman of the Nuclear Regulatory Commission.

Malcolm L. Hurstell

Mr. Hurstell is presently the Senior Vice President of Energy Delivery of NOPSI, responsible for executive management of System Engineering, Division Operations, and Consumer Services. Mr. Hurstell has been employed by NOPSI for approximately 37 years having served as the Senior Vice President and General Manager of NOPSI, responsible for the day-to-day operations of NOPSI; Vice President of Engineering and Production of NOPSI, responsible for operations of the Engineering, Electric Power and Energy Procurement Departments of NOPSI; Vice President of Engineering of NOPSI; and Manager of the Engineering Department of the Electric Systems Planning

Division. During his NOPSI career he has served on the Middle South Operating Committee planning subcommittee and has been a member of the Middle South Operating Committee since 1975. In addition, Mr. hurstell has been Senior Vice President of Energy Delivery of LP&L since February of 1985.

Robert W. Jones

Mr. Jones is a principal with Morgan Stanley & Company, Inc. specializing in public utilities, and as such has played a role in managing financial securities for NOPSI's parent company, Middle South Utilities. Mr. Jones holds a B.A. from Colgate University and an M.B.A. from Harvard. He has been with Morgan Stanley since 1974.

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Mr. Jung has been a member of the NOPSI Board of Directors since 1957. He is Chairman of the Board of Jung Realty Co., Inc.

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Mr. Komanoff is a director and principal of Komanoff Energy Associates, an energy and economic consulting firm. He is a consultant, analyst and author on the economics of the electric utility, nuclear power and coal sectors of the United States economy. Mr. Komanoff has worked for the Council on Economic Priorities and the New York City Environmental Protection Administration. He has consulted for two agencies of the U.S. Congress, the U.S. Department of Energy, and government agencies of 15 states. Mr. Komanoff has written three books on the nuclear and coal electric generation, published in 1972, 1976 and 1981, which dealt with trends in electric power economics, technology, and regulation. In addition, he has published numerous articles in both general periodicals and professional journals. Mr. Komanoff has presented expert

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Mr. Krebs presently serves on the Board of Directors of both NOPSI and LP&L. He is Chairman and Chief Executive Officer of J.J. Krebs & Sons, Inc., an engineering consulting firm. Mr. Krebs received his B.S. in civil engineering from Tulane University.

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Edwin Lupberger

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Jack M. Lundberg

Mr. Lundberg is president of Lundberg, Marshall and Associates, Inc., a utility consulting firm which provides consulting services in such areas as generation and transmission system planning, financial feasibility studies and preliminary design and cost estimating. He received his B.S. in Electrical Engineering from the University of Wisconsin and a M.B.A. from New York University. Mr. Lundberg is a Professional Engineer in fourteen states and is a member of the Institute of Electrical and Electronics Engineers. He has been employed as an engineer for 23 years and has done extensive work in electric utility planning: while employed by American Electric Power Service Corporation, he participated in transmission planning, interconnection and pooling studies; while employed by Stanley Consultants, he conducted generation, transmission and distribution planning studies for rural and municipal electric systems. While employed by R.W. Beck and Associates, he worked primarily on planning and analyses related to electric power supply arrangements, feasibility studies, economic analyses, contract negotiations and rate studies. Mr. Lundberg has testified on public utility matters before the Federal Energy Regulatory Commission, the Nuclear Regulatory Commission, and the state commissions of Colorado, Michigan, Minnesota, Missouri, New Mexico, Ohio and Texas.

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Mr. McLetchie is the Senior Vice President of Accounting & Finance, and Treasurer of both NOPSI and LP&L—a position he has held since 1984. His responsibilities include NOPSI's and LP&L's accounting and financial reporting as well as their financing programs. In addition, he makes

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Gregory A. Palast

Mr. Palast is a Senior Associate with Union Associates, a consulting firm. He has served as Executive Director of the New York State Legislature's Commission on Science and Technology, Economist to the State Assembly's Subcommittee on Public power and has taught economics at Indiana University. In addition, he serves as Consulting Economist to the Labor Coalition on Public Utilities, Chicago. Mr. Palast received his M.B.A. from the University of Chicago Graduate School of Business where he specialized in Finance of Regulated Industries. Mr. Palast has testified before utility commissions and legislatures in approximately fifty proceedings on issues such as utility financial reorganization, rate of return, income tax accounting and other financial issues. He has studied, developed, and/or testified on plans to solve rate and financial problems posed by the addition of major generating plants. Such studies have included, among others, the Wolf Creek plant (Kansas), the Shoreham plan (New York), the Zimmer plant (Ohio), the Seabrook plant (Maine and New Hampshire) and the Limerick plant (Pennsylvania).

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John B. Smallpage

Mr. Smallpage has been a member of the NOPSI Board of Directors since 1969. He is owner of Donovan Marine Inc. Mr. Smallpage received his B.S. in Engineering and M.B.A. from Tulane University.

William H. Talbot

Mr. Talbot is presently a Vice President, Assistant to the President and Secretary of NOPSI. He also serves as Secretary for the NOPSI Board of Directors; as secretary he is responsible for the records of all board activities, preparation of the agenda for the board meetings and preparation of the minutes of the NOPSI board meetings.

Charles Teamer

Mr. Teamer has served on the NOPSI Board of Directors since 1978. He is the Vice President of Fiscal Affairs at Dillard University in New Orleans where he has been employed in various capacities for approximately 20 years. Mr. Teamer has a Bachelor Degree in Business Administration and has studied business and finance at several graduate schools.

Regis G. Trumps

As Vice President of System Planning and Forecasting at Middle South Services, Inc. ("MSS"), Mr. Trumps is in charge of the department responsible for assisting the Middle South operating companies in forecasting future electric demand and energy requirements on the Middle South system as well as developing long range expansion plans to accommodate the forecasted requirements. He has been an employee of the Middle South system for 29 years, having joined NOPSI in 1956. He has served as Manager of the electric system planning division of NOPSI, MSS Manager of System Planning, MSS Director of System Planning and Forecasting, and MSS Executive Director of System Planning and Forecasting. He has attended meetings of the Middle South Operating Committee ("MSOC") for over 15 years and served as Secretary of the MSOC from 1978-1984, August 1985 to date. Mr. Trumps graduated from the University of Southwestern Louisiana with a B.S. in Electrical Engineering and has done graduate work at Tulane University.

Robert T. McWhinney

Mr. McWhinney is presently a management consultant and a Director of Putnam, Hayes & Bartlett, Inc. (PHB), an economic and management consulting firm. Mr. McWhinney received his B.S. in Engineering from the United States Naval Academy and his M.B.A. from Stanford University. During his tenure with the Navy, he served as a Nuclear Engineering Division officer and as the Polaris Weapons Officer. Subsequently, he was involved in establishing the Siting Office of the FERC's Energy Resource Development Program and the Safeguards Policy Office within the Regulatory Division of the Atomic Energy Commission. He was Operations Manager in the division of TRW, responsible for the technical consulting assistance TRW provided its energy clients, and later became Vice president and Director of Resource Planning Associates

until its merger with PHB. Mr. McWhinney has provided testimony on the prudence of management decisions before the Federal Energy Regulatory Commission and the Texas Public Utilities Commission. He has authored a guide to strategic management published by the Edison Electric Institute.

Jack M. Wyatt

Mr. Wyatt presently serves on the Board of Directors of both NOPSI and LP&L. Mr. Wyatt is retired but has been employed by both LP&L and Systems Fuel Inc., another MSU subsidiary. He served as LP&L President from 1976 through 1982 and as LP&L Chairman of the Board from 1982 through 1983.

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Respondents.

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QUESTION PRESENTED

Whether, under the abstention doctrines of *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943), or *Younger* v. *Harris*, 401 U.S. 37 (1971), a federal district court may refuse to adjudicate a federal claim that a federal statute (in this case the Federal Power Act) and the explicit orders of a federal agency (here FERC) have preempted local regulatory authorities from making separate and inconsistent determinations of the very matters FERC has decided?

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PETITIONER'S BRIEF[1]

OPINIONS BELOW

The opinion of the Court of Appeals (Cert. App. 1A-20A) is published at 850 F.2d 1069. The opinion of the District Court (Cert. App. 21A-33A) is unpublished.

JURISDICTION

The opinion and judgment of the Court of Appeals were entered on July 28, 1988. Cert. App. 1A-20A & 35A. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

[1]The Rule 28.1 Statement appears at page ii of the Petition for Certiorari.

STATEMENT OF THE CASE

Introduction

The question presented in this case is whether principles of comity and federalism can bar a federal court from enjoining a local utility proceeding that is preempted in its entirety by a federal statute and that is interfering with interstate commerce in the very ways that Congress sought to prevent by giving a federal agency exclusive jurisdiction over the underlying interstate transactions.

The question arises in a case presenting an immediate need for the exercise of federal equitable jurisdiction. Congress enacted the Federal Power Act because it recognized that wholesale sales of electric power inevitably affect multiple states and that interstate commerce vital to the nation would be threatened unless a neutral federal forum were established to allocate interstate power pool costs among ratepayers in different states and between ratepayers and utility shareholders.

In *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, No. 86-1970, 108 S. Ct. 2428 (June 24, 1988) ("*MP&L*"), this Court held that the very FERC decisions at issue in this case preempt a state from investigating the "prudence" of costs that FERC has ordered local utilities and their ratepayers to incur and that the Federal Power Act requires retail regulatory authorities to treat these costs as "reasonably incurred operating expenses" in setting retail rates.[2] As the Court stated, local regulators "may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates" or otherwise "trap" these expenses. 108 S. Ct. at 2439, slip op. at 16-17; *accord Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953, 965-66 (1986).

[2] "These principles . . . . compel us to hold that [local regulators] may not enter an order 'trapping' the costs [the local utility] is mandated to pay under the FERC order allocating Grand Gulf power or undertake a 'prudence' review for the purpose of deciding whether to enter such an order." 108 S. Ct. at 2439, slip op. at 17; *see id* at 2438, slip op. at 16.

Here, however, the Council of the City of New Orleans ("Council") has done precisely what *MP&L* and *Nantahala* held to be unlawful: it undertook a prudence review of petitioner's federally mandated Grand Gulf 1 expenses and entered an Order disallowing and "trapping" $135 million of those costs for retail ratemaking purposes. Moreover, the Council has continued to enforce its Order, despite this Court's intervening *MP&L* decision and despite the fact that the Council's *amicus curiae* briefs in *MP&L* unsuccessfully urged that such prudence disallowances are permissible. Thus, the Court of Appeals correctly "assum[ed]" that the Council had no legitimate interest in conducting its prudence investigation; that its Order is "beyond the Council's retail ratemaking authority;" and that a state court, or this Court, will eventually so hold. Cert. App. 11A, 20A. It follows that the sole effect of abstention has been to delay the vindication of explicit federal rights.

However, in the interim, the delays have severely harmed petitioner and the federal policies Congress sought to achieve. To obtain any rate relief at all, petitioner was previously forced to agree to a settlement in which $51 million in Grand Gulf 1 expenses would be absorbed by shareholders, contrary to FERC's determinations. And the Council's Order disallowing and "trapping" an additional $135 million of these expenses has imperiled the financing of petitioner's operations, contrary to the Congressional intent that utilities recover wholesale costs incurred under FERC rate schedules. In short, abstention is immediately harming protected federal interests in a case in which *no* legitimate substantive state interest is being served in the pending state proceedings.

1. Background. This case arises from the same facts and the same FERC orders that were at issue in *Mississippi Power & Light Co.* v. *Mississippi ex rel. Moore*, No. 86-1970, 108 S. Ct. 2428 (June 24, 1988) ("*MP&L*"). Here, as there, a local utility regulator is attempting to use its retail ratemaking authority to circum-

vent the FERC decisions that allocated the costs of Grand Gulf 1 among the operating company subsidiaries of Middle South Utilities, Inc. ("MSU").[3]

Petitioner New Orleans Public Service Inc. ("NOPSI") is one of four MSU electric operating subsidiaries engaged in the retail sale of electricity in separate service areas in Louisiana, Arkansas, Missouri, and Mississippi. The other MSU operating companies are Mississippi Power & Light Company ("MP&L"), Louisiana Power & Light Company ("LP&L"), and Arkansas Power & Light Company ("AP&L"). MSU also owns all the voting stock of an electric generating subsidiary, Middle South Energy, Inc. ("MSE"),[4] which owns Grand Gulf Nuclear Electric Generating Station Unit 1 ("Grand Gulf 1").

NOPSI provides retail electric service in the City of New Orleans. NOPSI's retail rates are regulated by the Council of the City of New Orleans ("Council"), which is an elected body.

[3]FERC initially made the allocations and wholesale rate determinations at issue here in *Middle South Energy, Inc.*, FERC Opinion No. 234, 31 FERC (CCH) ¶ 61,305 (1985) and *Middle South Energy, Inc.*, FERC Opinion No. 234-A, 32 FERC (CCH) ¶ 61,425 (1985). These opinions were reviewed by the United States Court of Appeals for the District of Columbia Circuit in *Mississippi Industries* v. *FERC*, 808 F.2d 1525, *modified on rehearing*, 822 F.2d 1104 (D.C. Cir. 1987), *cert. denied*, 108 S. Ct. 500 (1987). There, the Court of Appeals affirmed FERC's jurisdictional determinations and its decision on most cost allocation issues but remanded for reconsideration of the decision to equalize nuclear capacity costs. On remand, FERC has issued two opinions reaffirming and further explaining the basis for its previous allocation: *System Energy Resources, Inc.*, FERC Opinion No. 292, 41 FERC (CCH) ¶ 61,238 (1987) and *System Energy Resources, Inc.*, FERC Opinion No. 292-A, 42 FERC (CCH) ¶ 61,091 (1988), *petitions for review pending, City of New Orleans* v. *FERC*, Nos. 88-1067, 88-1068, 88-1124, and 88-1198 (D.C. Cir.). The FERC decisions will be cited as "_____ FERC at _____."

[4]MSE has since been renamed System Energy Resources, Inc. ("SERI"). *See* Cert. App. 3A.

The MSU companies have built or acquired electric generation to meet the needs of the MSU system as a whole, and "[t]hrough MSU the four companies operate as an integrated power pool, with all energy in the entire system being distributed by a single dispatch center." *MP&L*, 108 S. Ct. at 2431, slip op. at 2. The costs of this electricity are allocated among the MSU companies under rate schedules that determine each operating company's costs of acquiring power for resale to its retail customers and that "equaliz[e] cost imbalances among the four companies." *See MP&L*, 108 S. Ct. at 2431, slip op. at 2.

In 1982, before Grand Gulf 1 began operations, the MSU companies filed with FERC a rate schedule (the Unit Power Sales Agreement or "UPSA")[5] that would determine the wholesale rates to be paid for Grand Gulf 1's generation and also allocate its costs and output among the four MSU companies.[6] *See MP&L*, 108 S. Ct. at 2433, slip op. at 5. As originally filed, this rate schedule would have allocated 29.80% of the costs and output of Grand Gulf 1 to NOPSI.

FERC conducted extensive proceedings to determine the "just and reasonable" rates for Grand Gulf 1 power and to prescribe a "just, reasonable, and non-discriminatory" allocation of Grand Gulf 1's costs and output among the four MSU operating companies. The City of New Orleans ("City")[7] and representatives of

[5]In 1982, the MSU companies also filed a new System Agreement, which set forth the terms and conditions for wholesale transactions among the four MSU operating companies and which was "designed to ensure that each company contribute proportionately to the total costs of generating power on the system." *MP&L*, 108 S. Ct. at 2433, slip. op. at 5.

[6]MSU had previously sold a 10% interest in Grand Gulf 1 to the South Mississippi Electric Power Association (SMEPA). *See* 31 FERC at 61,668 n.3. The UPSA and the FERC proceedings dealt with the allocation of the MSU system's share of Grand Gulf 1 among the MSU companies and shareholders. The UPSA and the FERC decisions thus allocated 100% of the MSU system's 90% of Grand Gulf 1.

[7]The City acted at the direction of the Council.

each affected state participated extensively in these FERC proceedings. *See MP&L*, 108 S. Ct. at 2433, slip op. at 5-6; Cert. App. 4A. The representatives of each jurisdiction advanced arguments under which its operating utility would be allocated little or no Grand Gulf 1 output. For example, the City urged that NOPSI be responsible for no more than 9% of Grand Gulf 1.

FERC found that Grand Gulf 1 had been planned, constructed, and completed to meet the needs of the MSU system "as a whole" (*MP&L*, 108 S. Ct. at 2434, slip op. at 7), and FERC established rates that would permit MSE to "recoup 100% of the costs of Grand Gulf in the wholesale rates it charged to the four operating companies." *MP&L*, 108 S. Ct. at 2441, slip op. at 20. Specifically, FERC concluded that "principles of just, reasonable, non-discriminatory, and non-preferential rates" required an allocation of Grand Gulf 1's costs and output in which the four operating companies would "share the cost of the system's investment in nuclear energy in proportion to their relative demand for energy generated by the system as a whole." *MP&L*, 108 S. Ct. at 2435, slip op. at 9.

In so holding, FERC rejected the arguments of local regulators that allocations of Grand Gulf 1 should be based on (1) whether individual companies needed Grand Gulf capacity,[8] (2) representations that operating company officials had made to state and local officials,[9] or (3) the companies' contractual allocations.[10]

[8]*See MP&L*, 108 S. Ct. at 2435, 2441, slip op. at 9, 21; 32 FERC at 61,958; *Mississippi Industries, Inc.* v. *FERC*, 808 F.2d at 1549 n.93.

[9]*See MP&L*, 108 S. Ct. at 2441 n.14, slip op. at 21-22 n.14; 31 FERC at 61,645; *Mississippi Industries, Inc.* v. *FERC*, 808 F.2d at 1550.

[10]*See MP&L*, 108 S. Ct. at 2434, 2435, slip op. at 8, 9; 31 FERC at 61,655; 32 FERC at 61,961; *Mississippi Industries, Inc.* v. *FERC*, 808 F.2d at 1556-57, 1558-60.

FERC thus prescribed substantial changes in the Grand Gulf 1 allocations among the MSU companies:

	UPSA as filed	FERC's Allocation
AP&L	0%	36%
LP&L	38.57%	14%
MP&L	31.63%	33%
NOPSI	29.80%	17%

FERC therefore ordered a reduction in NOPSI's allocation from 29.80% to 17%. At the same time, FERC rejected the City's position that NOPSI should be allocated no more than 9%, holding that such an allocation would not result in "just, reasonable, and nondiscriminatory rates." *32 FERC at 61,959-60.*

The net effect of FERC's Order was that when Grand Gulf 1 went into operation on July 1, 1985, NOPSI was required by FERC to purchase 17% of Grand Gulf 1's capacity and to incur Grand Gulf 1 costs of approximately $15.5 million per month.

2. Prior Proceedings. On May 17, 1985, NOPSI filed an application with the Council for the retail rate increase required to recover these Grand Gulf 1 costs. NOPSI demonstrated that, without a substantial rate increase, it would have soon become insolvent.

When the Council failed to act upon NOPSI's initial application, NOPSI, on August 1, 1985, filed an action in federal district court to enforce its right to recover these FERC-mandated costs. *NOPSI* v. *City of New Orleans*, No. 85-3398 (E.D. La.) ("*NOPSI I*"). NOPSI contended that the Federal Power Act preempts local regulatory authorities from examining the reasonableness of expenses incurred under FERC-mandated rates and that none of these expenses may be disallowed for retail ratemaking purposes.

On September 16, 1985, the District Court dismissed *NOPSI I* under the Johnson Act (28 U.S.C. § 1342) and abstention principles. On February 14, 1986, the Fifth Circuit issued an opinion that reversed on both grounds, and remanded for a determination whether the "filed rate" doctrine required recognition of NOPSI's FERC-mandated Grand Gulf 1 costs. *New Orleans Public Service, Inc.* v. *City of New Orleans*, 782 F.2d 1236 (5th Cir. 1986). However, on September 2, 1986, the Fifth Circuit, on its own motion, reversed itself, and held that the District Court did not abuse its discretion in abstaining. *Id.*, 798 F.2d 858 (5th Cir. 1986), *cert. denied*, 481 U.S. 1023 (1987).[11]

After the District Court dismissed *NOPSI I*, the Council, on October 10, 1985, adopted a resolution initiating an investigation into the prudence of NOPSI's involvement in Grand Gulf 1 for the purpose of determining what portion of Grand Gulf 1 expenses should be assumed by shareholders, rather than being passed through to ratepayers. The Council Resolution that instituted the prudence investigation provides that:

> "The Council's investigation shall include inquiry into all aspects of NOPSI's prudence regarding its decisions to enter into its arrangements to purchase a portion of Grand Gulf 1 for the purpose of determining what portion, if any, of NOPSI's Grand Gulf 1 expense shall be assumed by its shareholders, rather than passed through to its retail ratepayers." Resolution No. R-85-636; *see* J.A. 16.

On November 14, 1985, NOPSI brought a parallel case to enjoin the Council's prudence investigation. *NOPSI* v. *Council of New Orleans*, No. 85-5273 (E.D. La.) ("*NOPSI II*"). *NOPSI II* was dismissed by the district court on grounds of abstention and ripeness. In defending that judgment on appeal, the Council stated that it *would* fully recognize the FERC-mandated Grand Gulf 1 expenses in setting retail rates. Notwithstanding the language

[11]The Fifth Circuit did not disturb its holding that the Johnson Act did not deprive the District Court of jurisdiction.

of its ordinance initiating the inquiry, the Council stated that its prudence investigation would deal solely with whether it could find savings in other areas of NOPSI's operation that would partially offset the rate increases required to recover NOPSI's Grand Gulf 1 expenses. *See New Orleans Public Service, Inc.* v. *Council of New Orleans*, 833 F.2d 583, 586 (5th Cir. 1987). This representation led the Fifth Circuit to hold that the underlying Federal Power Act claim was not ripe, and to decline to reach the question whether *NOPSI II* was properly dismissed under abstention principles. *Id.* at 588.

In March, 1986, while *NOPSI I* was pending on appeal, NOPSI and the Council entered into a partial "settlement." It provided that shareholders would absorb $51 million of the Grand Gulf 1 expenses, and authorized rate increases in which NOPSI could, on a phased-in basis, ultimately recover the rest of its Grand Gulf 1 expenses. This settlement is embodied in a Council Resolution that determined NOPSI's non-Grand Gulf retail revenue requirements and all rate design issues. Resolution No. R-86-112 (March 20, 1986); *see* J.A. 20-21.

However, in the settlement, the Council reserved its alleged right to continue the ongoing prudence investigation and to order adjustments in NOPSI's rates on the basis of that investigation. NOPSI, in turn, reserved its right to pursue its claim that the Council is preempted from conducting the prudence inquiry and from ordering the disallowance of any additional Grand Gulf 1 expenses.

3. The Council's $135 Million Disallowance. On February 4, 1988, the Council entered an Order that violated its representation to the Fifth Circuit in *NOPSI II*.[12] This Order disallowed $135 million of NOPSI's previously incurred Grand Gulf 1 ex-

[12]The Council's Order was issued at its first regularly scheduled meeting after the Fifth Circuit's mandate issued in *NOPSI II*. The Order apparently had been written by October of 1987, but the Council withheld its decision until *NOPSI II* was final.

penses on grounds of management "imprudence." *See* J.A. 10-250. This $135 million disallowance would produce a total loss to NOPSI of approximately $300 million (including carrying costs of $165 million). R. 18 Ex. 2, p. 7.

To implement this prudence disallowance, the Council ordered reductions in NOPSI's future retail rate increases authorized by the March, 1986 settlement. Specifically, the Council ordered reductions of approximately $500,000 per month in 1988, of $1 million per month in 1989, of $1.5 million per month in 1990, and of an additional $500,000 per month in each succeeding year through 1995. This $135 million of "trapped costs" is in addition to the $51 million that NOPSI previously agreed to absorb in the March, 1986 Settlement with the Council.

Although other findings were made,[13] the Council's $135 million disallowance ultimately rests on its findings that the Grand Gulf 1 power was "excessively priced or uneconomic for other reasons"[14] and that "prudent" NOPSI management thus should

[13]The Council relied on two other findings that are squarely foreclosed by FERC's decisions. First, the Council found that NOPSI's management had been ignorant of important events that affected NOPSI's Grand Gulf 1 commitment at the same time NOPSI's management publicly portrayed this plant as a great benefit to ratepayers. J.A. 24, 161-62. The Council's Order makes no attempt to square this finding with FERC's findings that Grand Gulf 1 was constructed and completed to serve the system as a whole, and that conditions affecting any one operating company were irrelevant. *Compare id. with* 31 FERC at 61,645; *see MP&L*, 108 S. Ct. at 2434, 2441, slip op. at 7, 21.

Second, the Council found that it was imprudent for NOPSI to agree to 29.60% of Grand Gulf 1 in 1982, and should have, instead, taken steps to reduce its exposure in the wake of the 1979 Three Mile Island accident. J.A. 24-25. The Council made no attempt to square this finding with FERC's holding that the agreed-upon allocations were irrelevant and that the Federal Power Act required that NOPSI be responsible for a share of the system's nuclear investment proportionate to its share of system-wide demand. *Compare id. with* 31 FERC at 61,633, 61,655; *see MP&L*, 108 S. Ct. at 2433 n.7, slip op. at 6 n.7.

[14]*See* Brief of Council of City of New Orleans, et al. In Opposition To Petition, p. 8 n.5 (filed Sept. 26, 1988) ("Council Cert. Opp.").

have entered into contracts in 1979-80 to sell "that portion of [NOPSI's] commitment which exceeded a 9 percent share of Grand Gulf" and to buy equivalent amounts of coal-fired capacity at hypothetically lower rates. J.A. 25.

In the Council's view, NOPSI today should be: (1) buying 17% of Grand Gulf 1's capacity at the "excessive" rate set by FERC; (2) selling 8% of that "excessively priced" Grand Gulf output to some extraordinarily generous or naive third parties who would pay that *same* "uneconomic" FERC rate; and (3) acquiring the equivalent of 8% of Grand Gulf 1's output at the hypothetical (lower) cost of alternative coal-fired generation. *See* J.A. 11-12, 161-73. As the District Court found, the Council nowhere explains how prudent management could find a "sucker" to buy "excessively priced" Grand Gulf 1 capacity when the same quantities of power could be purchased at lower prices through open market purchases. Cert. App. 30A. Nor does the Council explain how NOPSI could have entered into the hypothetical off-system contracts in 1979-80 when neither the price[15] of Grand Gulf 1 power nor the amount of NOPSI's allocation[16] would be determined by FERC until 1985, five or six years later.[17]

[15]The premise of the Council's Order is that no other utility knew that the price of Grand Gulf 1 would be "excessive" or "otherwise uneconomic" in 1980. The Council nowhere explains how another utility could have bound itself in 1980 to make future wholesale purchases of power at whatever price would be determined five years later, no matter how "excessive."

[16]In 1979-80, NOPSI's allocation could have theoretically ranged from the 9% urged by the Council to amounts in excess of the 29.70% to which NOPSI had agreed in the UPSA. Thus, even if NOPSI could have then contractually limited its Grand Gulf 1 commitment to 9% by making off-system sales and purchases, NOPSI could not have known how much Grand Gulf 1 power it would have had to sell or how much substitute coal-fired capacity it would have had to buy. The experience of AP&L is instructive. In 1980, it contracted for a Grand Gulf 1 share of 0%. In 1985, FERC changed that share to 36%.

[17]The Council has extensively relied on the fact that NOPSI's President testified in 1980 that "*if*" and when the Council disapproved NOPSI's participation in Grand Gulf 1, "*then* NOPSI has the option of

(Footnote continued on following page)

Further, the Council's finding that NOPSI could have and should have used off-system sales and purchases to avoid Grand Gulf 1 costs not only determines matters within FERC's exclusive jurisdiction, but also is contrary to FERC's own determinations in FERC Opinions 234 and 234-A. The Council's finding that "prudent" NOPSI management should have avoided FERC's allocation rests on the premise that the allocation was unreasonable. That is contrary to FERC's determinations. *See* ***MP&L***, 108 S. Ct. at 2434, slip op. at 8. Further, even if NOPSI had entered into the hypothetical off-system transactions in 1980, those contracts were themselves wholesale transactions that would not be approved unless they were found "just, reasonable, and nondiscriminatory" by FERC. In all events, FERC has exclusive jurisdiction to determine how the hypothetical 1980 contracts would affect NOPSI's Grand Gulf 1 allocation, and the findings and methodology in FERC's subsequent 1985 decisions foreclose any claim that the hypothetical 1980 sales could have reduced NOPSI's wholesale power costs by $135 million.[18]

(Footnote continued from previous page)

selling the capacity and marketing it . . . to other electric utilities." *See* J.A. 102; Council Cert. Opp. p. 5-6 (emphasis added). In now relying upon this statement, the Council ignores that (1) the Council did not disapprove NOPSI's participation in 1980, (2) neither the price nor quantity of Grand Gulf 1 power had been determined in 1980, and (3) any wholesale sales by NOPSI, and the question of how such sales would affect NOPSI's Grand Gulf allocation and its overall purchased power expenses, were themselves committed to FERC's exclusive jurisdiction. Finally, the Council ignores that this Court held in ***MP&L*** that representations made in state utility proceedings have "no relevance to the preemption question" presented by FERC's Grand Gulf 1 allocation. ***MP&L***, 108 S. Ct. at 2441 n.14, slip op. at 22 n.14.

[18]FERC's 1985 decision allocated MSU's 90% share of Grand Gulf 1 among the four MSU operating companies to equalize nuclear investment costs in proportion to each company's share of system demand. *See* pp. 5-6 & n.6, *supra*. In ordering this allocation, FERC held that contracts entered into by individual MSU companies in 1980 were irrelevant and could not alter the allocation dictated by FERC's ratemaking

(Footnote continued on next page)

In the *amicus curiae* briefs that the Council filed in this Court in the ***MP&L*** case, the Council presented its theory that Grand Gulf 1 costs can lawfully be disallowed on the ground that it was imprudent not to make off-system sales. The Council further contended that the Court could not reverse the Mississippi Supreme Court's decision unless it held that such a Grand Gulf 1 "prudence" disallowance is also preempted by federal law.[19]

4. This Suit. On February 9, 1988, NOPSI filed this suit in federal district court to obtain declaratory and injunctive relief from the Council's Order. NOPSI's claim is that the Federal Power Act and the Commerce Clause preempt the Council's jurisdiction to investigate the prudence of FERC-mandated costs and require that those costs be treated as reasonable operating expenses in setting retail rates. No state law issue was raised, and the complaint rests solely on these federal grounds. *See* R. 1. NOPSI demonstrated that it would suffer irreparable harm

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principles. *See* 31 FERC at 61,655; 32 FERC at 61,961. Under FERC's methodology, any off-system sales would have reduced the MSU system's total nuclear costs, and the benefits of such cost reductions would have been proportionately allocated among the operating companies in order to fulfill FERC's stated goal of equalizing nuclear unit investment costs.

Thus, if NOPSI could have sold 8% of Grand Gulf 1 off-system in 1980, FERC's methodology would have dictated that this off-system sale, too, be regarded as benefitting the system as a whole, and that NOPSI continue to receive a 17% allocation of MSU's share of Grand Gulf 1 (which would have been reduced from 90% to 82%). Under FERC's methodology, therefore, the net effect to NOPSI of an 8% off-system sale would have been a 1.36% reduction (17% of 8%) in its Grand Gulf 1 costs. In contrast, under FERC's methodology, the only way NOPSI could have reduced its Grand Gulf 1 allocation to the 9% assumed by the Council would have been by selling not 9% of Grand Gulf 1, but 53% (9% = 17% of 53%)—which, of course, NOPSI could not do.

[19]Brief of Council of City of New Orleans As Amicus Curiae, *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970, p. 10 (filed January 22, 1988); Brief of Council of City of New Orleans As Amicus Curiae, *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970, pp. 13-15 & n.10 (filed August 10, 1987).

so long as the Council's Order remained in effect, and NOPSI sought preliminary as well as permanent injunctive relief. *See* R. 2, R. 15, R. 17, & R. 18; Cert. App. 9A.

Without holding a hearing on NOPSI's motion for a preliminary injunction, the District Court dismissed the case on March 10, 1988 on grounds of abstention. Cert. App. 21A-33A. The District Court then remanded two other suits to state court.[20] The District Court stated that it was "mystified" by the Council's Order, which "fault[ed] NOPSI not for buying a 'pig in a poke' but for failing to find a sucker to buy it when the faux-pas became apparent." Cert. App. 30A & n.11. The District Court further observed that the Council "pulled from thin air a figure of 8% for the prudence disallowance" when "the Council, and in this case, everyone else knows" that the Council was just collaterally attacking FERC's rejection of the 9% allocation the Council proposed in the FERC proceeding. The District Court further observed that the 8% "bear[s] no apparent relationship to [any] savings" that were "possible in an actual economic market." However, the District Court stated that "[t]hese questions must be resolved on another day in another court." Cert. App. 30A n.11.

Because of the uncertainty over the availability of a federal forum (*see* Cert. App. 10A), NOPSI had no choice but to file a

[20]Simultaneously with the issuance of the Council's order on February 4, 1988, both the Council and a consumer organization filed lawsuits in state court. Both suits were filed within minutes of the Council's vote and before the Council meeting adjourned. The Council's suit sought a declaratory judgment that the Council's Order was lawful and that NOPSI must comply with it. *Boissiere* v. *Cain* , No. 88-2503 (Civ. Dist. Ct. Parish of Orleans, La., filed Feb. 4, 1988). The consumer organization's suit claimed that the Council should have disallowed all, or far more, of the Grand Gulf 1 costs. *Alliance For Affordable Energy, Inc.* v. *Council of New Orleans*, No. 88-2502 (Civ. Dist. Ct. Parish of Orleans, La., filed Feb. 4, 1988). NOPSI removed both suits to federal district court where they were consolidated with the instant suit. *See* Cert. App. 27A n.6. The district court remanded both suits to state court in light of its abstention holding.

petition to review the Council's Order in the Civil District Court for the Parish of Orleans, Louisiana. NOPSI did so on March 7, 1988, the last day to file an appeal under the applicable limitations period. *NOPSI* v. *Council of New Orleans*, No. 88-4511 (Civ. Dist. Ct. Parish of Orleans, La.). As filed, NOPSI's petition for review raised only state law and federal Due Process Clause claims, but NOPSI told the state court that it would attempt to raise the federal preemption and Commerce Clause claims in the state suit only if the federal court subsequently dismissed NOPSI's federal complaint.[21] When the District Court did so, NOPSI amended its state complaint to include a federal preemption claim, and NOPSI filed a motion for preliminary injunction on federal preemption grounds, which the state court denied on May 5, 1988.[22]

After this Court decided *MP&L* on June 24, 1988, NOPSI abandoned all the claims raised in the state complaint other than its federal preemption claim and a challenge to the sufficiency of the evidence to support the disallowance.[23] Thus, if and when the state court decides the case on the merits,[24] the only ground

[21]*See* NOPSI's Petition for Review, *NOPSI* v. *Council of New Orleans*, No. 88-4511 (Civ. Dist. Ct. Parish of Orleans, La.), p. 3 ¶ 9 (filed March 7, 1988).

[22]NOPSI appealed this order denying a preliminary injunction to the intermediate Louisiana appellate court (the Court of Appeal) which twice denied requests to expedite the appeal. On February 16, 1989, the Court of Appeal affirmed the denial of the preliminary injunction solely on state procedural grounds, and the court stated that it "express[es] no opinion" on whether the Council's order "crosses over into an area of exclusive federal regulation." *NOPSI* v. *Council of New Orleans*, No. 88-CA-1369, slip op. at 4 (4th Cir. La. Ct. App.).

[23]NOPSI's Memorandum in Support of Petition for Review, *NOPSI* v. *Council of New Orleans*, No. 88-4511 (Civ. Dist. Ct. of Parish of Orleans, La.), p. 3 (filed Aug. 8, 1988).

[24]The parties to the state trial court proceeding have filed cross motions for judgment on the merits. Oral argument on these motions was held on November 30, 1988, but the parties will hereafter file post-argument briefs.

that would finally dispose of the Council's Order is the federal preemption claim that is the basis for this case. In contrast, any state court decision based on sufficiency of the evidence would require a remand to the Council, which could then renew its prudence inquiry.

5. The Court of Appeals Decision. The United States Court of Appeals for the Fifth Circuit affirmed the District Court's decision to abstain. Although the Fifth Circuit recognized that its decision conflicted with those of other courts of appeals, it held that it was bound by its earlier decision in *NOPSI I*. Cert. App. 17A-20A.

NOPSI I held that abstention was proper under *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943). *NOPSI I* recognized that "no state law issue seems relevant" to this case and that there was no risk that federal court intervention would result in inconsistent state and federal court decisions on questions of state law. Nevertheless, it held that "[t]he motivating force behind *Burford* abstention is not the desire to avoid a state law question, but rather, a reluctance to intrude into state proceedings where there exists a complex state regulatory system" and where the state administrative and judicial system affords "adequate" opportunities to raise federal claims. *NOPSI I*, 798 F.2d at 861, 862.

NOPSI I also held that these same considerations established that this case met the conditions for abstention under *Younger* v. *Harris*, 401 U.S. 37 (1971). First, *NOPSI I* held that "the administrative proceeding before the Council constitutes an ongoing judicial proceeding" because it is " 'within the appellate jurisdiction' of the Louisiana courts." *NOPSI I*, 798 F.2d at 864. Second, *NOPSI I* found that NOPSI "would have a full and fair opportunity to litigate its federal claims" in state court. *Id*. Third, *NOPSI I* held that federal court relief would affect legitimate state functions because "[t]he interest of the Council of New Orleans in setting retail rates is clearly important." *Id*.

In the present case, the Fifth Circuit acknowledged that the language in the Court's decision in *MP&L* "seem[ed] to foreclose" the Council's prudence investigation and its Order disallowing $135 million in Grand Gulf 1 expenses. Cert. App. 13A. Indeed, the Fifth Circuit assumed that the Council's prudence investigation is " 'beyond the Council's retail ratemaking authority and violates federal law' "; that "the Rate Order results in 'trapping' FERC allocated costs in violation of federal law"; and that "the Rate Order itself demonstrates that the disallowance of rate increases was based on factors that the state could not legally consider." Cert. App. 11A. It nevertheless held that, under the law of the Fifth Circuit, NOPSI could not challenge the legitimacy of the state prudence proceeding in federal court, but "must seek relief" in the state proceedings themselves. Cert. App. 20A.

SUMMARY OF ARGUMENT

The Fifth Circuit has held that the mere pendency of a state proceeding warrants abstention by a federal court even when it must be assumed that the state has no legitimate substantive interest in conducting the proceeding because state jurisdiction is preempted by a federal statute. This holding conflicts with four decades of decisions of this Court.

The Fifth Circuit's rule rests on a misapprehension of both *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943), and *Younger* v. *Harris*, 401 U.S. 37 (1971). Abstention cannot be ordered under either line of decisions unless a federal court first determines that pending state proceedings implicate legitimate state substantive interests and are not preempted by federal law.

Burford. This Court's decisions squarely reject the Fifth Circuit's holding that *Burford* abstention can be ordered when there is "no state law issue" and no risk that federal court adjudication would disrupt a state's efforts to assure consistency in regulatory matters in which the state has a legitimate interest. That was the whole basis for *Burford*, and this Court has repeatedly held that

Burford abstention is improper unless "federal review . . . would be disruptive of state efforts to establish a coherent [state] policy with respect to a matter of substantial public concern" and would be unlikely to advance any substantial federal interest. *Colorado River Water Conservation Dist.* v. *United States*, 424 U.S. 800, 814 (1976). In contrast, federal claimants may not be remitted to state remedies when, as here, the claimed rights are federal and are not "in any way entangled in a skein of state law that must be untangled before the federal case can proceed." *McNeese* v. *Board of Education*, 373 U.S. 668, 674 (1963); *see Zablocki* v. *Redhail*, 434 U.S. 374, 380 n.5 (1978).

Accordingly, in the same year and same term that *Burford* was decided, this Court held that principles of comity and federalism cannot prevent a federal district court from enjoining a pending state utility proceeding that is preempted in its entirety by the very federal statutory scheme at issue here. *Public Utility Comm'n of Ohio* v. *United Fuel Gas Co.*, 317 U.S. 456, 467-69 (1943) (Natural Gas Act). Federal claimants cannot be relegated to state remedies when, as here, "the only question is whether it is constitutional to fasten the administrative procedure onto the litigant." *Public Utilities Comm'n of California* v. *United States*, 355 U.S. 534, 539-40 (1958).

Younger. The same considerations foreclose abstention under *Younger*. *Younger*, too, rests on a "balancing" in which both "federal and state interests ha[ve] to be taken into account" (*Trainor* v. *Hernandez*, 431 U.S. 434, 438 (1977) (Blackmun, J., concurring)), and all members of the Court have made it clear that abstention is improper where the only state interest in the pending proceeding is to *adjudicate* a federal claim. *See, e.g.*, *Pennzoil Co.* v. *Texaco, Inc.*, 481 U.S. 1, 14 n.12 (1987); *id.* at 19-20 (Brennan, J., and Marshall, J., concurring); *id.* at 27-28 (Blackmun, J., concurring); *id.* 30 n.2 (Stevens, J., concurring). *Younger* abstention cannot be ordered unless the court first independently determines that the pending proceeding implicates

"legitimate" and "important" state substantive interests. *See, e.g.*, *Trainor* v. *Hernandez*, 431 U.S. at 441; *Middlesex County Ethics Comm.* v. *Garden State Bar Ass'n*, 457 U.S. 423, 432 (1987); *Younger*, 401 U.S. at 44.

Younger abstention thus cannot apply to claims that federal law ousts the state of jurisdiction to conduct the pending proceeding. A federal court cannot abstain under *Younger* without first deciding that the putative state substantive interest is "legitimate:" that is, one that has not been preempted. *See Knudsen Corp.* v. *Nevada State Dairy Comm'n*, 676 F.2d 374, 377 (9th Cir. 1982). That is precisely what this Court did in *Ohio Civil Rights Comm'n* v. *Dayton Christian Schools, Inc.*, 477 U.S. 619, 628 (1986); it abstained only after deciding that federal law did not preempt the state from exercising jurisdiction over the controversy. Thus, virtually every other court of appeals to consider the question has held that the "legitimate state interest contemplated by *Younger* . . . does not exist when the state action has been preempted" by a federal statute. *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 772 F.2d 404, 417 (8th Cir. 1985).

Finally, respondents concede that *Younger* abstention is improper when the state utility order is invalid on its face. That is the case here because the Council has conducted a prudence review for the very purpose that this Court held to be unlawful in *MP&L*: the disallowance and "trapping" of the Grand Gulf 1 costs that FERC has ordered NOPSI to incur. *MP&L*, 108 S. Ct. at 2438, slip op. at 15.

ARGUMENT

Burford and *Younger* are each applications of principles of comity and federalism that have governed federal equity practice for two centuries: "federal courts should be wary of interrupting the proceedings of state administrative [and judicial] tribunals by use of the extraordinary writ of injunction" and should do so only

to protect overriding federal interests. *Public Utility Comm'n of Ohio* v. *United Fuel Gas Co.*, 317 U.S. 456, 468-69 (1943). The Fifth Circuit's rule constitutes a major extension of these abstention principles.

The Fifth Circuit has held that the mere pendency of state proceedings warrants abstention by a federal court even when it must be assumed that the state has no legitimate substantive interest in conducting the pending proceedings because the state jurisdiction is preempted by a federal statute. The Fifth Circuit so held, moreover, in a case in which the state order is irreparably harming the federal interests that Congress sought to protect, in which there is no state law issue, and in which the state's only interest is an adjudicatory one: deciding an already-settled federal law issue in state tribunals.

However, this Court has repeatedly held that a federal court has no "judicial discretion to dismiss a suit merely because a State court could entertain it." *Alabama Pub. Serv. Comm'n* v. *Southern Ry. Co.*, 341 U.S. 341, 361 (1951) (Frankfurter, J., concurring); *accord Pennzoil Co.* v. *Texaco, Inc.*, 481 U.S. 1, 14 n.12 (1987). "Abstention from the exercise of federal jurisdiction is the exception, not the rule." *Colorado River Water Conservation Dist.* v. *United States*, 424 U.S. 800, 813 (1976). Federal district courts have an "unflagging obligation" to exercise their jurisdiction to vindicate federal rights and to protect federal interests (*id.* at 817), and a federal court can abstain from "adjudicat[ing] a controversy properly before it . . . only in the exceptional circumstances where the order to the parties to repair to the state court would clearly serve an important countervailing interest." *County of Allegheny* v. *Frank Mashuda Co.*, 360 U.S. 185, 188-89 (1959).

Four decades of decisions of this Court establish that such an interest cannot exist unless the pending state proceeding promotes a legitimate and important state substantive interest. Thus, this Court has rejected arguments that considerations of comity

and federalism can foreclose federal equitable relief in cases challenging state utility commission proceedings or orders that interfere with the very federal statutory scheme at issue here.[25] And with good reason. In contrast to *Burford* and *Younger*, the only laws and the only courts whose interests are at stake in this case are those of the federal government, and the "balance" between state and federal interests is clear. Indeed, this Court has held that the issue in such preemption cases is "essentially one of federal policy" and that " 'federal courts are particularly appropriate bodies for the application of preemption principles.' "[26]

I. There Is No Basis For Abstention Under *Burford*.

The Fifth Circuit's abstention holding rests primarily on this Court's decision in *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943). The Fifth Circuit recognized that there is "no state law issue that seems relevant" to the case, *NOPSI I*, 798 F.2d at 861, and that a federal court's adjudication of NOPSI's federal preemption claim would not disrupt the state efforts to assure consistency in state law. However, the Fifth Circuit concluded that "the motivating force behind *Burford* is not the desire to avoid a state law question, but rather, a reluctance to intrude into state regulatory proceedings where there exists a complex state regulatory system" that involves matters of "local concern." *Id.* at 862. In this circumstance, the Fifth Circuit held that federal courts can and should abstain from deciding federal preemption claims—and

[25] *Public Utilities Comm'n of Ohio* v. *United Fuel Gas Co.*, 317 U.S. 456, 468-69 (1943) (Natural Gas Act). This Court has stated many times that the "relevant provisions of [the Natural Gas Act and the Federal Power Act] 'are in all material respects substantially identical' " and that it is the Court's "established practice" to "cit[e] interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 n.7 (1981) (citations omitted).

[26] *Hagens* v. *Lavine*, 415 U.S. 528, 550 (1974) (citations omitted); *United Mine Workers* v. *Gibbs*, 383 U.S. 715, 729 (1966); *see also Swift & Co.* v. *Wickham*, 382 U.S. 111 (1965).

remit the federal claimant to its state administrative and judicial remedies—so long as there is an adequate opportunity to raise the federal claim in the state proceeding itself.

The Fifth Circuit's reasoning has been repeatedly rejected by this Court's decisions. They establish that abstention cannot be ordered under *Burford* unless a case presents "difficult questions of state law bearing on policy problems of substantial public import" and unless "federal review . . . would be disruptive of state efforts to establish a coherent [state] policy with respect to a matter of substantial public concern," without advancing any substantial federal interest. *Colorado River Water Conservation Dist.* v. *United States*, 424 U.S. 800, 814 (1976).

That was the case in *Burford*. It involved a challenge to an order entered under an exceedingly complex scheme of state oil conservation. Under the state system, the Texas Railroad Commission regulated the spacing of wells in an oil field to assure that a surface owner could not drain away the oil under adjacent parcels (or the entire field), but could remove the equivalent of the amount of the oil under his land. Because the state oil conservation law standards were amorphous and complex, Texas had established a specialized court to review the determinations of the Texas Railroad Commission, to prevent inconsistencies in the interpretation of state standards, and to assure that each oil field was "regulated as a unit for conservation purposes." *Burford*, 319 U.S. at 319.

In ordering abstention, this Court pointed out that "[t]he federal government . . . has chosen to leave the principal regulatory responsibility with the States" (*id.*) and that the plaintiff was simply claiming that this legitimate state authority had been exercised unreasonably in violation of state law and also the Due Process Clause of the Fourteenth Amendment. *See id.* at 317, 331 n.28. This Court found that the determination of the state law issue would be dispositive of nearly all such cases. *Id.* at 331.

Accordingly, the Court reasoned that the only consequence of permitting a multiplicity of federal district courts to decide such cases would be to create conflicts in the interpretation of state law and undermine the exercise of legitimate state authority in an area in which uniformity in state law was critical, and in which the federal interest was minimal. *Id.* at 329-34.

The only other decision of this Court that has permitted abstention on this ground is *Alabama Public Service Comm'n* v. *Southern Railway Co.*, 341 U.S. 341 (1951). There, a federal plaintiff challenged the public service commission order prohibiting discontinuance of intrastate railroad passenger service on the ground that the order was unreasonable, and thus violated both the state statute and the Due Process Clause of the Fourteenth Amendment. In *Alabama Public Service Commission*, as in *Burford*, the state had concentrated judicial review of commission orders in a particular branch of its court system. *Id.* at 348-49. As in *Burford*, the Court concluded that review of the administrative order would be based on predominantly local factors and that intervention by a federal court would disrupt the state's efforts to develop uniform criteria. *Id.*

In contrast, the Court has repeatedly held *Burford* abstention improper when, as here, the federal court challenge to state administrative activity raises only federal claims. For example, in *McNeese* v. *Board of Education*, 373 U.S. 668 (1963), the Court refused to relegate the federal claimants to their state remedies because the claimed rights were federal in origin and were not "in any way entangled in a skein of state law that must be untangled before the federal case can proceed." *Id.* at 674. And the Court has also flatly rejected the Fifth Circuit's suggestion that the fact that the proceeding raises "local concerns" can justify abstention when there is a substantial claim that the state order violates federal law. "[T]here is, of course, no doctrine requiring abstention merely because resolution of a federal question may result in the overturning of a state policy." *Zablocki* v. *Redhail*, 434 U.S.

374, 380 n.5 (1978). The "importance to the State of its own law is not material when there is a conflict with a valid federal law." *Brown* v. *Hotel Employees*, 468 U.S. 491, 503 (1984) (citation omitted); *Fidelity Federal Savings & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141, 153 (1982) (citations omitted).

Indeed, in the same term and same year in which *Burford* was decided, the Court held that principles of comity and federalism cannot prevent federal courts from adjudicating preemption claims indistinguishable from the claim NOPSI has made. In *Public Utilities Comm'n of Ohio* v. *United Fuel Gas Co.*, 317 U.S. 456 (1943), the Court upheld a federal court injunction against a state utility commission's pending investigation of the "just and reasonable" rate that a retail operating company paid for gas purchased from a wholesale supplier. The Court recognized that the state commission's investigation was related to the setting of retail rates and that "federal courts should be wary of interrupting the proceedings of state administrative tribunals by use of the extraordinary writ of injunction." *Id.* at 468-69. However, the Court held that remitting the federal plaintiff to its state remedies would defeat the overriding federal interests. It reasoned that "the orders of the state commission are on their face plainly invalid" because the Natural Gas Act gave FERC's predecessor (the Federal Power Commission) exclusive jurisdiction to determine just and reasonable wholesale rates. The Court held that an injunction was required because the state proceedings would "provok[e] needless, wasteful litigation," require needless expenditures by the utility, and "would work injury" to the interests Congress sought to "safeguard by enacting the Natural Gas Act." *Id.* at 467-469.

Subsequent decisions of this Court have thus uniformly upheld federal district court injunctions of state utility proceedings or orders that are preempted by federal law. *Public Utilities Comm'n of California* v. *United States*, 355 U.S. 534 (1958); *see also City of Chicago* v. *Atchison, T. & S.F. Ry. Co.*, 357 U.S. 77 (1958).

These decisions establish that a federal claimant cannot be remitted to its state remedies when, as here, "the only question is whether it is constitutional to fasten the administrative procedure onto the litigant." *Public Utilities Comm'n of California*, 355 U.S. at 540.

Indeed, because *Burford* abstention cannot be appropriate unless federal court jurisdiction would disrupt *legitimate* efforts by a state to establish coherent policies, the Ninth Circuit has held that "*Burford* abstention is particularly inappropriate when the plaintiff's claim is based on preemption, because abstaining under *Burford* would be an implicit ruling on the merits." *Knudsen Corp.* v. *Nevada State Dairy Comm'n*, 676 F.2d 374, 377 (9th Cir. 1983).

For these reasons, the overwhelming majority of courts of appeals to address the question have held that *Burford* cannot apply to bar federal court adjudication of a substantial federal preemption claim. As the Ninth Circuit has held:

> "The purpose of *Burford* abstention is to avoid federal intrusion into matters which are largely of local concern and which are within the special competence of local courts. A preemption claim alleges in essence that Congress has determined that particular matters are of national concern and should be administered by national, rather than local, institutions. If a preemption claim is well-founded, therefore, *Burford* abstention cannot be appropriate."

International Bhd. of Electrical Workers v. *Public Service Comm'n*, 614 F.2d 206, 212 n.1 (9th Cir. 1980); *accord Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Utility Comm'n*, 791 F.2d 1111, 1115-16 (3d Cir. 1986); *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 772 F.2d 404, 417 (8th Cir. 1985); *Baggett* v. *Department of Professional Regulation*, 717 F.2d 521, 524 (11th Cir. 1983).[27] As Judge Friendly stated, "abstention

[27] *But see Aluminum Company of America* v. *Utilities Comm'n of North Carolina*, 713 F.2d 1024 (4th Cir. 1983) (upholding *Burford* abstention in face of preemption claim); *American Electric Power Co.* v. *Kentucky Public Service Comm'n*, 787 F.2d 588 (6th Cir. 1986) (same).

is peculiarly inappropriate when the federal claim is that the state has been ousted from jurisdiction" by a federal statute, for "such difficulties in statutory construction as exist pertain rather to the relevant federal laws, and a federal court is better equipped to deal with these" than is a state tribunal. *Chemical Specialty Mfgs Ass'n, Inc.* v. *Lowery* , 452 F.2d 431, 433 (2d Cir. 1971); *see also Hagens* v. *Lavine*, 415 U.S. 528, 550 (1974); p. 21 n. 26, *supra*.

Against this background, the Fifth Circuit manifestly erred in abstaining under *Burford*. The sole issue in this case is not only a federal preemption claim that federal courts are uniquely equipped to decide, but also a claim that this Court has repeatedly upheld. *See MP&L*, 108 S.Ct 2428 (June 24, 1988); *Nantahala Power & Light* v. *Thornburg*, 476 U.S. 953 (1986); *see also Public Utilities Comm'n of Ohio* v. *United Fuel Gas Co.*, 317 U.S. 456 (1943). Adjudication of this claim by a federal court could not disrupt state interests in establishing uniform standards.[28] To the contrary, it is the decision to abstain that has here disrupted a regulatory scheme designed to promote uniformity.[29]

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[28]Indeed, even if there were a state law issue in the case, there would still be no basis for abstention under *Burford*. A precondition to any finding that federal court review could produce inconsistent interpretations of state law is that review of regulatory orders be concentrated in a specialized court. The Civil District Court for the Parish of Orleans has jurisdiction over appeals of Council rate orders simply because both NOPSI and the Council are within the territorial jurisdiction of that court. However, under Louisiana law, most Louisiana utilities are regulated by the Louisiana Public Service Commission (LPSC), and its orders are reviewed by the district court in Baton Rouge, where the LPSC sits. *See* La. Rev. Stat. Ann. ch. 45, § 1192 (West 1982). The LPSC has no authority to regulate a utility, like NOPSI, that is regulated by the governing authority of a political subdivision. La. Const. art. 4, § 21(C) (West 1977).

[29]*See Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983); *FPC* v. *Southern California Edison & Electric Co.*, 273 U.S. 83 (1964).

Here, as in *United Fuel Gas*, the Council's proceeding has produced the very "multiple litigation" and additional expenditures Congress sought to prevent by centralizing regulation of interstate wholesale energy transactions in FERC. *See Public Utilities Comm'n of Ohio* v. *United Fuel Gas Co.*, 317 U.S. at 469. But the Council has interfered with FERC's regulation far more severely than did the state utility commission order enjoined in *United Fuel Gas*. After the Council initially refused to recognize any of NOPSI's FERC-mandated Grand Gulf 1 expenses, the Council extracted a "settlement" agreement that permanently "trapped" $51 million in federally mandated costs, contrary to *MP&L*, *Nantahala*, and the Congressional purpose of promoting vital commerce by assuring recovery of wholesale costs incurred under FERC-approved schedules. The subsequent Council Order at issue here traps an additional $135 million in costs and will continue severely to impair NOPSI's ability to finance its operations until the Order is enjoined. *See* Cert. App. 12A-13A. Moreover, the Council entered its Order after having *participated* in the FERC proceedings and having unsuccessfully urged the result that the Council's Order would impose. This is an affront to the federal scheme.

Conversely, a federal injunction would not affect any legitimate state retail ratemaking function. The Council's 1986 Settlement Resolution determined NOPSI's non-Grand Gulf 1 retail revenue requirements, prescribed how NOPSI's Grand Gulf 1 expenses would be phased in, and determined all other rate design issues. This case does not challenge any aspect of that retail rate order. Nor would it interfere with the Council's ability to perform these legitimate state functions in the future. Rather, all NOPSI seeks to enjoin is the subsequent Council Order that disallows $135 million of federally mandated Grand Gulf 1 costs on grounds of "imprudence" and that is thus preempted in its entirety by the Federal Power Act. In short, this is a quintessential case for the exercise of federal equitable jurisdiction.

II. The Doctrine of *Younger* v. *Harris* Does Not Authorize Abstention.

These same considerations establish that abstention cannot be justified under *Younger* v. *Harris*, 401 U.S. 37 (1971), and the numerous cases holding that there are certain conditions in which federal courts cannot enjoin pending state judicial or administrative proceedings.[30] Like *Burford*, *Younger* does not permit abstention merely because a state civil proceeding is pending, and like *Burford*, *Younger* cannot bar federal court adjudication of a substantial claim that the state order is preempted in its entirety by a federal statute. In any event, *Younger* manifestly cannot apply when, as here, it is clear that the state order is "invalid on its face" and is irreparably harming interests protected by a federal statute.

A. *Younger* Rests On An Accommodation Of State And Federal Interests And *Younger* Abstention Is Flatly Improper Where The Only State Interest Is Adjudicatory.

Younger's doctrine of equitable restraint implements the same broad principles of comity and federalism that is the basis for *Burford*: "the National Government, anxious though it may be to vindicate and protect federal rights and federal interests, always endeavors to do so in ways that will not *unduly* interfere with *legitimate* activities of the States." *Younger*, 401 U.S. at 44 (emphasis added). *Younger* thus requires a "balancing" in which "both federal and state interests ha[ve] to be taken into account"

[30] *Younger* bars a federal court from enjoining a pending state judicial or administrative proceeding if (1) the state proceeding implicates important and legitimate state interests; (2) there is an adequate opportunity to raise the federal claim in the state proceeding; and (3) the state proceeding is not brought in bad faith, does not rest on a "patently unlawful" statute incapable of valid application, and presents no other exceptional circumstances requiring federal court intervention. *See, e.g.*, *Middlesex County Ethics Comm.* v. *Garden State Bar Ass'n*, 457 U.S. 423 (1982).

(*Trainor* v. *Hernandez*, 431 U.S. 434, 448 (1977) (Blackmun, J., concurring)), and "there is a sensitivity to the legitimate needs of both State and *National* Government." *Younger*, 401 U.S. at 44 (emphasis added).

Younger and its progeny recognize that judicial comity is a two-way street. Just as it is important that federal courts not encroach upon substantial state interests, it is equally important that federal courts fulfill their responsibilities when the only relevant issues and interests are federal rather than state.

Under these principles, the mere fact that there is an adequate opportunity to raise federal claims in a pending state proceeding cannot justify a federal court's refusal to vindicate federal rights and to protect overriding federal interests. As all the members of this Court have recognized, *Younger*'s doctrine of equitable restraint cannot be invoked unless the state has a "*substantive* interest in the ongoing proceeding, an interest that goes beyond its interest as adjudicator." *Pennzoil Co.* v. *Texaco, Inc.*, 481 U.S. at 30 n.2 (Stevens, J., concurring) (emphasis in original).[31] As the Opinion for the Court stated in *Pennzoil*, "our opinion does not hold that *Younger* abstention is always appropriate whenever a civil proceeding is pending in state court." *Id.* at 14 n.12. There is not even a potential *Younger* bar unless the federal court proceeding could interfere with substantive state functions that are "legitimate" (*Trainor* v. *Hernandez*, 431 U.S. at 441) and "important." *Middlesex County Ethics Comm.* v. *Garden State Bar Ass'n*, 457 U.S. 423, 432 (1982). That requirement is not satisfied by a state's adjudicatory interest in having its state court resolve federal issues.

[31] *Accord Pennzoil Co.* v. *Texaco, Inc.*, 481 U.S. at 14 n.12 (Opinion of the Court); *id.* at 19-20 (Brennan, J., and Marshall, J., concurring); *id.* at 27-28 (Blackmun, J., concurring); *Ohio Civil Rights Comm'n* v. *Dayton Christian Schools, Inc.*, 477 U.S. 619, 628 (1986); *Middlesex County Ethics Comm.* v. *Garden State Bar Ass'n*, 457 U.S. at 432-34; *Trainor* v. *Hernandez*, 431 U.S. 434, 442-44 (1977); *id.* at 453-56 (Brennan, J., dissenting); *Juidice* v. *Vail*, 430 U.S. 327, 335-36 (1977); *id.* at 344-45 (Brennan, J., dissenting).

The threshold requirement that there be an important, legitimate substantive state interest before abstention can be ordered was established in *Younger* itself. There, the plaintiff sought to enjoin a pending state criminal prosecution that was brought in good faith on the ground that the underlying criminal statute was void for vagueness and overbreadth in violation of the First Amendment. The Court recognized that the state had an obvious and legitimate substantive interest in the enforcement of its criminal law—so much so that decades of prior decisions had established that requiring a federal claimant to defend a criminal prosecution does not constitute "irreparable harm" when the prosecution is brought in good faith. *Younger*, 401 U.S. at 45-47, 51-52. Further, the Court independently determined that the state criminal statute was susceptible to an "acceptable narrowing construction" in the state proceeding and that "once this was done, prosecutions could then be brought for conduct occurring before the narrow construction was made, and proper convictions could stand so long as the defendants were not deprived of fair warning." *Id.* at 50.[32]

Younger thus ordered dismissal of the challenge to the pending state criminal prosecution on the ground that a federal injunction would unduly interfere with a state's legitimate activities. *Id.* at 41. At the same time, *Younger* recognized several exceptions to the principle that federal courts should not enjoin state proceedings or orders that further legitimate state interests. First, the Court held that abstention is improper when the state prosecution is brought in bad faith. *See id.* at 48-49; *Dombrowski* v. *Pfister*, 380 U.S. 479, 485-86 (1965). Second, the Court held that abstention may be improper when the state criminal statute is "flagrantly and patently violative of express constitutional provisions in

[32]When the state has a legitimate substantive interest, *Younger* abstention thus "offers the opportunity for narrowing constructions that might obviate the constitutional problem and intelligently mediate federal constitutional concerns and state interests." *Moore* v. *Sims*, 442 U.S. 415, 429-30 (1979).

every clause, sentence, and paragraph, and in whatever manner and against whomever an effort might be made to apply it." *Younger*, 401 U.S. at 53-54 (quoting *Watson* v. *Buck*, 313 U.S. 387, 402 (1941)); *see also Trainor* v. *Hernandez*, 431 U.S. at 447. Finally, the Court recognized that there could be other "exceptional circumstances" that could permit federal equitable intervention. *Younger*, 401 U.S. at 54.

In any case in which an allegation is made that an exception to *Younger* applies, the court must address that claim and independently decide whether abstention is improper. That is, the federal court first decides whether the threshold requirement for the *Younger* exception is met, and if it is, then the federal court decides the federal issue. *See Dombrowski* v. *Pfister*, 380 U.S. at 485-86.

Similarly, this Court's subsequent *Younger* decisions uniformly establish that the Court must independently determine whether the pending state proceeding implicates "important" and "legitimate" state substantive interests before it can abstain under *Younger*. Indeed, *Younger* was thereafter extended to cases seeking to enjoin obscenity regulation,[33] the enforcement of state court judgments through execution or contempt,[34] the prosecution of welfare fraud,[35] child abuse regulation,[36] bar disciplinary proceedings,[37] and the enforcement of antidiscrimination laws[38] *only because* the Court found that the state had important and legitimate substantive interests that it was seeking to vindicate in each such case.

[33]*Huffman* v. *Pursue, Ltd.*, 420 U.S. 592 (1975).

[34]*Pennzoil Co.* v. *Texaco, Inc.*, 481 U.S. at 12-14; *Juidice* v. *Vail*, 430 U.S. 327 (1977).

[35]*Trainor* v. *Hernandez*, 431 U.S. 434 (1977).

[36]*Moore* v. *Sims*, 442 U.S. 415 (1979).

[37]*Middlesex County Ethics Comm.* v. *Garden State Bar Ass'n*, 457 U.S. at 432-34.

[38]*Ohio Civil Rights Comm'n* v. *Dayton Christian Schools, Inc.*, 477 U.S. 619 (1986).

The Court's decisions equally establish that *Younger* cannot bar a federal court adjudication when, as here, the federal claim is that the state's jurisdiction to conduct the proceeding is ousted by federal law and that the state, therefore, may have no "legitimate" or "important" substantive interest. These principles apply with special force here, moreover, because the Council's Order is so clearly invalid and is irreparably harming protected federal interests.

B. *Younger* Cannot Apply When There Is A Substantial Claim That The Challenged State Proceedings Are Preempted By Federal Law In Their Entirety And There Is No State Law Issue.

Absent other considerations, *Younger* cannot prevent a federal court from adjudicating a well-pleaded claim that a federal law has preempted state jurisdiction over a subject matter, and deprived the state of any legitimate substantive interest to conduct the pending proceeding. Indeed, because *Younger* abstention depends on a holding that the state's substantive interest is "legitimate" and "important," a decision to abstain here, as in *Burford*, is "an implicit ruling on the merits" "when the plaintiff's claim is based on preemption." *Knudsen Corp.* v. *Nevada State Dairy Comm'n*, 676 F.2d 374, 377 (9th Cir. 1982).

This is the clear teaching of the Court's holdings that federal claimants cannot be required to exhaust state administrative and judicial remedies when they have presented valid claims that state utility proceedings or orders are preempted by a federal statute. *See* pp. 24-25, *supra*. Indeed, the Court has upheld injunctions against state proceedings that are merely investigating the wholesale energy transactions committed to FERC's exclusive jurisdiction. *Public Utilities Comm'n of Ohio* v. *United Fuel Gas Co.*, 317 U.S. 456 (1943).

Moreover, the correctness of the Ninth Circuit's statement that a federal court cannot abstain without deciding the merits of such

threshold challenges to state jurisdiction is made explicit in *Ohio Civil Rights Comm'n* v. *Dayton Christian Schools, Inc.*, 477 U.S. 619 (1986). There, a sectarian school had sought to enjoin a state civil rights commission from either (1) investigating the school's decision to terminate a teacher, or (2) imposing any sanctions at the conclusion of the pending investigation. The court of appeals had ordered the entry of the injunction on the ground that the pending investigation violated the Religion Clauses of the First Amendment. This Court reversed and ordered the dismissal of the suit on *Younger* grounds.

However, the Court so held *only after* it decided the threshold constitutional challenge to the state's jurisdiction to investigate the school and rejected that federal claim on the merits. The Court held that "the Commission violates no constitutional rights by merely investigating the circumstances of [the] discharge in this case, if only to ascertain whether the ascribed religious-based reason was in fact the reason for the discharge." *Id.* at 628. In short, the Court recognized that *Younger* abstention could not be ordered without first determining that the state had a substantive interest in investigating the school that was not "preempted" by federal law, and that was therefore "legitimate."[39] *See* P. Bator, D. Meltzer, P. Mishkin & D. Shapiro, *Hart and Wechsler's The Federal Courts and the Federal System* 1435 (3d Ed. 1988).

For these reasons, the majority of federal courts of appeals that have considered the issue have concluded that federal courts may not refuse to adjudicate substantial claims that the state's regulatory jurisdiction has been preempted by a federal statute. They hold that the pendency of state proceedings alone cannot bar a federal district court from adjudicating federal preemption claims

[39] *Dayton* thus required the District Court to rule on NOPSI's preemption claim before it could even consider abstaining. Because *MP&L* squarely held that the state "interest" in conducting such a prudence inquiry is preempted (108 S. Ct. at 2439, slip op. at 16-17), *Dayton* and *MP&L* foreclosed abstention under *Younger* here.

that go to the "power of the state administrative agency to proceed at all" and that "no deference is due state proceedings which would entrench on the exclusive federal domain." *Baggett* v. *Department of Professional Regulation*, 717 F.2d 521, 524 (11th Cir. 1983).

Specifically, the courts of appeals reason that the "legitimate state interest contemplated by *Younger*. . . does not exist when the state action has been preempted or foreclosed" by a federal statute. *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 772 F.2d 404, 417 (8th Cir. 1985) (citation omitted). The "notion of 'comity' embodied by the *Younger* doctrine is 'not strained when a federal court cuts off state proceedings that entrench upon the federal domain.' " *Kentucky West Virginia Gas Co.* v. *Pennsylvania Public Utility Comm'n*, 791 F.2d 1111, 1117 (3rd Cir. 1986) (citations omitted); *accord Appalachian Power Co.* v. *Public Service Comm'n of West Virginia*, 614 F.Supp. 64, 70-71 (S.D. W. Va.), *aff'd*, 770 F.2d 159 (4th Cir. 1985); *see also Champion Int'l Corp.* v. *Brown*, 731 F.2d 1406, 1409 (9th Cir. 1984).

These principles do not establish that abstention is never appropriate when a federal preemption claim is raised. Abstention may still be warranted when decision of the federal question is " 'dependent upon, or may be materially altered by, an uncertain question of state law.' " *Cf. Lake Carriers' Ass'n* v. *MacMullan*, 406 U.S. 498, 511-12 (1972) (citation omitted); *Pennzoil Co.* v. *Texaco, Inc.*, 481 U.S. at 29 (Blackmun, J., concurring). But there is no such state law claim here. Similarly, abstention may also be warranted when the federal preemption claim is germane to some but not all issues in the pending state proceeding, and the federal court would be deciding individual issues on a "piecemeal" basis. *Cf. Moore* v. *Sims*, 442 U.S. at 426-27 n.10; *Trainor* v. *Hernandez*, 434 U.S. at 445. But here the federal preemption claim is dispositive of the entire state controversy. In short, there is no question but that the controlling principles barred *Younger* abstention in this case.

C. *Younger* Abstention Cannot Be Ordered When The Invalidity Of The State Proceeding And Order Is Clear On Its Face.

The foregoing discussion establishes that a federal court cannot refuse to adjudicate a substantial federal preemption claim that is dispositive of the entire state proceeding simply because the issue can be presented in the pending state proceedings. There is, moreover, an even narrower ground for decision in this case. As respondents concede,[40] *Younger* establishes that federal courts may not abstain from deciding a challenge to a state proceeding or order that is invalid on its face.[41] And the Council's Order of February 4, 1988 is facially invalid under this Court's holding in *MP&L*. *Accord Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986). Indeed, because the Council unsuccessfully urged that its proposed prudence disallowance was permitted by federal law in its *amicus* filings in *MP&L*, it is extraordinary that the Council would contend otherwise.

In *MP&L*, as here, a prudence review of MP&L's Grand Gulf expenses was ordered for the sole purpose of determining "whether the costs FERC had directed MP&L to pay for its allocation of Grand Gulf should be 'trapped' or passed on to . . . retail customers." *MP&L*, 108 S. Ct. at 2439 n.12, slip op. at 17 n.12; *compare* p. 8, *supra*. *MP&L* held that the earlier decision in

[40]Council Cert. Opp., pp. 13, 18-19, 25-27.

[41]There is an exception to the principles of *Younger* if a state statute is "flagrantly and patently violative of express constitutional prohibitions in every clause, sentence, and paragraph, and in whatever manner and against whomever an effort might be made to apply it." *Younger*, 401 U.S. at 53-54 (citations omitted). This is a standard that can seldom be satisfied when the claim is that a statute violates the Federal Constitution, for there are few instances in which a constitutional provision bars any and all state regulation of a subject matter. However, when a federal statute gives a federal agency exclusive jurisdiction over a subject matter and ousts any preexisting state authority, this standard is plainly satisfied. *See, e.g., Public Utilities Comm'n of Ohio* v. *United Fuel Gas Co.*, 317 U.S. 456 (1943).

Nantahala established that states have no jurisdiction to investigate the "prudence" of costs incurred under FERC rate schedules, but must treat the FERC-mandated expenses as "fair and reasonable when determining retail rates" and "may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates." *MP&L*, 108 S. Ct. at 2439, slip op. at 16-17. The Council's Order does precisely what *MP&L* forbids.

The Council's attempt to distinguish *MP&L* would be frivolous even if the Council's arguments had not been presented to the Court in *MP&L* itself. In *MP&L*, the Mississippi Attorney General had contended that Grand Gulf 1 should be paid for by shareholders because he alleged that this power is "excessively priced" and that it was thus imprudent for MP&L to acquire Grand Gulf 1 power for resale to retail customers. The Council's prudence disallowance rests on the same ground.[42] The only difference is that the Council purports to challenge not NOPSI's initial acquisition of the Grand Gulf 1 power, but rather NOPSI's retention of that power to serve its retail ratepayers.

But this is a distinction without a difference. A $135 million penalty could not be imposed on NOPSI for failing to avoid its Grand Gulf allocation unless the allocation was itself unreasonable. This Court held in *MP&L* that a prudence disallowance could not be based on such grounds:

> "But if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced Grand Gulf power that FERC has ordered it to pay for."

MP&L, 108 S. Ct. at 2440, slip op. at 19. Obviously, if it is reasonable to procure the power, it cannot be unreasonable to retain it.

[42]Council Cert. Opp., p. 8 n.5.

Further, the Council goes on to find that NOPSI could have avoided excessively priced or otherwise uneconomic power by (1) selling all but 9% of Grand Gulf 1's capacity to another utility at the very price contended to be "excessive" and "otherwise uneconomic," and (2) buying equivalent amounts of capacity at the hypothetically lower cost of coal-fired power. As the lower courts found, the Council's "logic" is "mystif[ying]," because not even a "sucker" would purchase more expensive Grand Gulf capacity if the same quantities of capacity could be purchased at lower prices on the open market. *See* p. 14, *supra*.

However, the decisive fact is that here, too, the Council is not only determining matters within FERC's exclusive jurisdiction, but also making findings that conflict with the very determinations made in FERC's decisions. As *MP&L* and *Nantahala* hold, FERC has exclusive jurisdiction to allocate lower-cost and higher-cost power among the companies in an integrated multistate system and to determine whether and how actual (or hypothetical) wholesale sales and purchases should alter the wholesale costs of any individual company. Thus, FERC alone has jurisdiction to determine whether NOPSI could have made the off-system wholesale sales and purchases of power which the Council's Order hypothesizes in 1980. And FERC alone has jurisdiction to determine whether and how such hypothetical 1980 transactions would have reduced NOPSI's wholesale costs. Further, FERC's findings and determinations foreclose the Council's conclusion that the hypothetical transactions would have reduced NOPSI's wholesale costs by $135 million. *See* pp. 12-13 & n.18, *supra*. Thus, the invalidity of the Council's Order could not be clearer.[43]

[43]The Council's sole response to these points is to argue that its Order has not disturbed the FERC wholesale rates and the underlying obligations, but has "merely" calculated retail rates by assuming a hypothetical reduction of wholesale costs. *See* Council Cert. Opp., p. 26. This contention is foreclosed by *Nantahala* and *MP&L*. Each holds that states cannot circumvent FERC regulation on such grounds. *Nantahala*, 476 U.S. at 955; *MP&L*, 108 S. Ct. at 2438, slip op. at 15.

But the short answer is that the Council unsuccessfully advanced these arguments to the Court in *MP&L* itself. The Council there stated, correctly, that the Mississippi Supreme Court's decision was "unclear as to the nature of the proposed prudence inquiry"[44] and that any Grand Gulf 1 "prudence" disallowances ordered on remand could well have adopted the Council's present theory.[45] The Council argued, at length, that such prudence disallowances are valid. By holding that Mississippi was preempted from conducting *any* prudence investigation and that *all* FERC-mandated costs must be passed through to retail ratepayers, the Court necessarily rejected the Council's current claims. Otherwise, this Court would have permitted the Mississippi prudence inquiry to go forward within the specified limits proposed by the Council in its *amicus* briefs. Thus, the Fifth Circuit assumption that the Council's Order is invalid on its face is correct. *See* Cert. App. 13A.

As the Council concedes, when such facial invalidity exists, there is no possible *Younger* bar to the issuance of federal equitable relief. *See* p. 35 & nn.40-41, *supra*. Indeed, the Court has upheld injunctions against state utility proceedings or orders that conflict on their face with exclusive grants of jurisdiction to federal agencies. *See* pp. 24-25, *supra*. The present case, in short, is a circumstance in which the balance overwhelmingly favors a federal court injunction.

III. In Any Event, It Was Error To Refuse To Entertain The Request For A Preliminary Injunction.

Finally, although NOPSI maintains that the federal court here was required to adjudicate the federal preemption claim on the

[44]Brief of Council of City of New Orleans As Amicus Curiae, *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970, p. 10 (filed January 22, 1988).

[45]*Id.*, pp. 14-24; *see also* Brief of Council of City of New Orleans As Amicus Curiae, *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970, pp. 13-15 & n.10 (filed August 10, 1987).

merits and issue permanent equitable relief, NOPSI submits that, in any event, it was reversible error for the Fifth Circuit to abstain from deciding NOPSI's request for a preliminary injunction. As the Fifth Circuit recognized, the Council's Order has caused immeasurable harm to NOPSI's protected federal interests and frustrated federal policy from the date the order was issued. *See* Cert. App. 9A.

Federal courts, at a minimum, must grant the interim relief required to protect overriding federal interests while the state proceedings are pending. Courts have endorsed the use of preliminary injunctions to prevent irreparable harm to federal interests in a host of analogous cases in the past. *See Babbitt* v. *United Farm Workers*, 442 U.S. 289, 312 n.18 (1979); *Romany* v. *Colegio de Abogados de Puerto Rico*, 742 F.2d 32, 45 n.13 (1st Cir. 1984); *Spartacus, Inc.* v. *Borough of McKees Rocks*, 694 F.2d 947, 949 & n.3 (3d Cir. 1982); *Catrone* v. *Massachusetts State Racing Comm'n*, 535 F.2d 669, 672 (1st Cir. 1976).[46]

[46]*See also* P. Bator, D. Meltzer, P. Mishkin & D. Shapiro, *Hart & Wechsler's the Federal Courts and the Federal System* 1375, 1422-23 (3d ed. 1988); Laycock, *Federal Interference with State Prosecutions: The Need for Prospective Relief*, 1977 Sup. Ct. Rev. 193, 277-78; Wells, *Preliminary Injunctions and Abstention: Some Problems in Federalism*, 63 Cornell L. Rev. 65 (1977).

CONCLUSION

For the reasons stated, the judgment of the United States Court of Appeals for the Fifth Circuit should be reversed.

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No. 88-348

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.*
Respondents.

On Writ of Certiorari to the United States
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QUESTION PRESENTED

Whether the courts below were correct in adhering to the established rules set forth in *Younger v. Harris*, 401 U.S. 37 (1971) and its progeny; *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1 (1987); and *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), and in holding that the district court could properly abstain, in favor of state review, from determining the merits of petitioner's action to enjoin enforcement of a state utility rate order on the basis of petitioner's claim that the Federal Energy Regulatory Commission ("FERC") had implicitly preempted state action; where,

(1) petitioner had been directed by the federal courts, years before, to channel its objections to this state regulatory proceeding through the state system, but had refused;

(2) petitioner had presented its preemption claim in the state regulatory proceeding, where it was fairly considered, but petitioner declined to pursue state judicial review;

(3) the state court system was open to hear petitioner's claims for preliminary and permanent relief based on federal and state issues;

(4) state court litigation concerning the rate order was pending;

(5) the "delay" of which petitioner complains was occasioned by its refusal to use the state courts;

(6) the establishment of local retail utility rates involves extremely sensitive, historically recognized local interests, as well as a longstanding system of state regulation;

(7) the action taken by the local regulator was, on its face, manifestly within its jurisdiction;

(8) the claim of preemption cannot reasonably be characterized as direct or facial, as the courts below and two state courts have held, and resolution of the federal claim requires an understanding of, and an effort to mediate, both federal and state interests;

(9) the state has not had a chance to establish an authoritative regulatory policy here, and failure to abstain would draw the federal courts into a review of the lowest echelon expression of state policy in this area; and assuming *arguendo* that further consideration of the preemption issue is appropriate,

(10) the action of the local regulator was in fact not preempted, when it (a) accepted as a "given" the FERC's allocation of costs; (b) dealt with the question of a utility's responsibility to reduce risk and found, on evidence not challenged here, that the utility's management was imprudent; (c) did not "trap" any costs, but did impose a disallowance because of the utility's failure to realize cost-savings through other transactions, as the utility said it could do; and (d) tailored its remedy so as to insure that the utility could meet its FERC-imposed obligations?

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BRIEF FOR RESPONDENTS THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.*

COUNTERSTATEMENT OF THE CASE

In their "Statements of the Case," petitioner ("NOPSI") and the government omit relevant facts, make assertions that contradict the record, and begin this case with the Court's *MP&L* decision.[1] This case has a less contrived starting point and deeper roots.

A. Introduction

This is the third federal action initiated by NOPSI for the purpose of interfering with state proceedings for the determination, and appellate review, of retail utility rates and practices.

This dispute first arose in 1985 when NOPSI filed an application with the Council for a retail rate increase to recover its share of the costs of the Grand Gulf I nuclear power plant ("Grand Gulf"), as authoritatively set by the FERC. Grand Gulf is, by any

[1] *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 108 S. Ct. 2428 (1988) ("*MP&L*"); (Pet. Br. at 2; Gov't Br. at 2).

standard, a commercial failure. Characterized by a federal appeals court as "catastrophically uneconomical,"[2] it entered service in 1985 at a cost exceeding $3.6 billion, nearly six times original projections. (JA-19.) NOPSI's share, if passed through fully and immediately, would have resulted in as much as a 60% increase in retail electric rates. (JA-21.) The "severe rate shock effect"[3] of such an immediate increase was potentially devastating.[4]

While the Council was considering — responsibly and in good faith[5] — NOPSI's application and certain rate moderation plans, NOPSI sued in federal court (a) to require the Council to pass through all Grand Gulf costs immediately and without moderation and (b) to intimidate, seeking $1 billion in damages from the Council members personally. After denying NOPSI's request for a preliminary injunction and directing NOPSI to seek interim relief from the Council, which NOPSI had spurned, the district court in September 1985 abstained. The Court of Appeals in September 1986 affirmed on that point. Both courts advised NOPSI to bring its challenges in the state adjudicatory system. *NOPSI I* (n.3 *supra*).

[2] *Mississippi Indus., Inc. v. FERC*, 808 F.2d 1525, 1528 (D.C. Cir.), *vacated in part*, 822 F.2d 1104 (D.C. Cir. 1987), *cert. denied*, 108 S.Ct. 500 (1987).

[3] *New Orleans Pub. Serv. Inc. v. City of New Orleans*, No. 85-3398, slip op. at 5 (E.D. La. Sept. 16, 1985), *rev'd*, 782 F.2d 1236 (5th Cir.), *modified and withdrawn in part*, 798 F. 2d 858 (5th Cir. 1986), *cert. denied*, 107 S. Ct. 1910 (1987) ("*NOPSI I*").

[4] Evidence developed in the Council proceedings showed that the immediate, unmitigated pass-through of Grand Gulf costs would result in the loss of over 6,000 jobs, make it impossible for over 1,100 otherwise qualified families to qualify for mortgage loans, push the income of 1,760 families below the poverty line, reduce state and local tax revenues by over $30 million annually, and otherwise have a profound adverse effect. (*See* JA-21 n.2.)

There was further concern for the so-called "death spiral" effect of "rate shock." That is, low-income residents as well as energy-intensive or marginal businesses, unable to pay electric bills, move or close. The unpaid costs are then passed on to a diminished customer base, further increasing their electric bills. This triggers a new round of failures, and so on, destroying the community's economy.

[5] In *NOPSI I*, the district court held that the Council "is utilizing every feasible alternative to keep NOPSI in a positive cash position" throughout its consideration of NOPSI's request for a rate increase, and further, that "the Council is determined to assist NOPSI in maintaining a positive cash position by pursuing a number of feasible alternatives." Slip op. at 11-12.

Despite the district court's abstention ruling, NOPSI filed a second federal action in November 1985, after the Council commenced a prudence inquiry.[6] The case, called "*NOPSI II*," originally sought to bar any Council inquiry into managemental prudence; it was later amended to seek only to bar any remedy affecting rates. It was dismissed on abstention and ripeness grounds by the district court in December 1986. The dismissal was affirmed on ripeness grounds in December 1987.[7]

The prudence inquiry went forward during 1986 and 1987, but did not delay a rate increase, which had been effected through settlement in March 1986, later described. In its prudence order (JA-10, *et seq.*, "the Rate Order"), the Council conformed its actions to the law, and on evidence of mismanagement and indifference that was overwhelming (JA-129-173), found NOPSI's management imprudent for having failed to pursue risk-reduction in the form of offsetting power sales that management had said it could make. The Council imposed a $135 million disallowance on this basis, "capped" at a level that NOPSI could "sustain" — *i.e.*, NOPSI could meet its Grand Gulf obligations, continue its operations, and return to financial health — and graduated its impact. (JA-210-211.) Aware of NOPSI's disposition to hold itself above state authorities, the Council commenced an action in state court seeking judicial review,[8] as did a citizens' group.[9]

NOPSI again shunned the state courts, and commenced this action in February 1988, seeking to enjoin the Council's order on preemption grounds,[10] and alleging irreparable harm (but not

[6] A prudence inquiry involves an examination of a utility's actions to determine whether management acted capably and reasonably under the circumstances prevailing and under decisional standards. (JA-42-52.) The established rule is that shareholders, not ratepayers, bear the costs of bad management. *See Missouri ex rel. Southwestern Bell Tel. Co. v. Pub. Serv. Comm'n*, 262 U.S. 276 (1923).

[7] *New Orleans Pub. Serv. Inc. v. City of New Orleans*, 833 F.2d 583 (5th Cir. 1987), *aff'g Middle South Energy, Inc. and New Orleans Pub. Serv. Inc. v. City of New Orleans*, No. 85-5273 (E.D. La. Dec. 19, 1986) ("*NOPSI II*").

[8] *Boissiere v. New Orleans Pub. Serv. Inc.*, No. 88-2503 (La. Civ. Dist. Ct. filed Feb. 4, 1988).

[9] *Alliance for Affordable Energy, Inc. v. Council of New Orleans*, No. 88-2502 (La. Civ. Dist. Ct. filed Feb. 4, 1988).

[10] The complaint only refers to an impact on interstate commerce with reference to a finding in the Rate Order for which no remedy was imposed. (R.1 ¶ 38.)

"great and immediate harm" or "extraordinary circumstances") — a claim contrary to the Council's own conclusion, based on extensive evidence, that NOPSI could sustain the disallowance. (JA-173-184; JA-209-210). On the last day possible, NOPSI filed a state court suit that contained only state claims,[11] and it wrote to the court indicating that its real interest was to litigate in federal court. Only after the federal court abstained did NOPSI raise its federal claims in state court and seek an injunction. But it did *not* claim that it was suffering any irreparable harm, nor has it *ever* done so in state court.

NOPSI's state application for a preliminary injunction was denied; and that denial was affirmed by an intermediate appellate court on the ground that there was no attempt to demonstrate irreparable harm.[12] The case is now in state civil district court. Oral argument has been heard upon motions for judgment; and both parties have agreed to a post-argument briefing procedure. If abstention is maintained, NOPSI's federal and state claims will be reviewed in the state court system, and any remaining federal questions will be preserved for review by this Court, if necessary.

Most of the following facts are set forth with greater particularity in the Rate Order.[13] For convenience, relevant portions of the Rate Order are cited next to each caption.

There has been no claim that the Rate Order shifted costs to the ratepayers elsewhere, nor, on the evidence, could there be. *See* p. 34 *infra*.

[11] *New Orleans Pub. Serv. v. City of New Orleans*, No. 88-4511 (La. Civ. Dist. Ct. filed Mar. 7, 1988). NOPSI complained that the Rate Order is arbitrary, capricious and not supported by substantial evidence; applies an erroneous standard of prudence; breached the March 1986 settlement agreement; violated NOPSI's Louisiana due process rights; and constitutes an unlawful "taking."

[12] *New Orleans Pub. Serv. Inc. v. City of New Orleans*, No. 88-4511 (La. Civ. Dist. Ct. filed May 5, 1988), *aff'd*, No. 88-CA-1369 (La. Ct. App. Feb. 16, 1989). NOPSI had also sought expedited review. Its first request was denied since the record had not yet been lodged, but it does not appear that NOPSI made any effort to expedite the record. Later, NOPSI renewed its request, which was denied. NOPSI also sought extraordinary "supervisory writs" from the Louisiana Supreme Court to bypass the intermediate courts, but these were denied. It is not clear how NOPSI intended to make its need for expedition or extraordinary writs credible in the absence of a claim of irreparable harm.

[13] NOPSI does not challenge the accuracy of the findings of fact in the Rate Order. Challenges to such findings are fundamentally issues to be resolved by the state courts in review of a state administrative order. *Cf. University of Tenn. v. Elliott*, 478 U.S. 788, 799 (1986); *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 484 n.26 (1982).

B. The Parties [JA-16-19]

The City of New Orleans is a Louisiana municipal corporation. Pursuant to Section 4-1604 of the Home Rule Charter, the Council is invested with "all powers of supervision, regulation and control over any" public utility within the city, and its regulatory power is recognized by the Louisiana Constitution of 1974. (JA-16.)[14]

NOPSI is an investor-owned utility engaged in the retail sale of electricity in New Orleans. NOPSI's rights and obligations with respect to electric service derive from the authorizations[15] of the Council, and its predecessor, that make regulation by the Council a predicate for NOPSI's right to collect rates. Ordinance No. 7068, enacted in 1922, authorized NOPSI "to charge and collect such fair and reasonable rates for electrical energy . . . as may be established by the City." (JA-18.)

NOPSI is a wholly-owned subsidiary of Middle South Utilities, Inc. ("MSU"), and is the smallest among the three other operating company subsidiaries — AP&L, LP&L and MP&L,[16] which provide electric service in neighboring regions. MSE (renamed SERI), is MSU's wholly-owned generation company which, during the relevant period, owned a 90% interest in Grand Gulf.[17]

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[14] With a brief exception, the Council has exercised regulatory jurisdiction over NOPSI since 1922. On November 23, 1981, pursuant to Ordinance No. 8264, a referendum caused regulatory authority over NOPSI to be transferred to the Louisiana Public Service Commission ("LPSC"). Such powers were returned to the Council in May 1985 pursuant to another referendum.

[15] The Council was empowered to issue a franchise and to regulate the utility pursuant to Article 14, Section 22, of the Louisiana Constitution of 1921 and by statute. La. Rev. Stat. Ann. § 33:4405.

[16] These names and terms have been previously defined or abbreviated in petitioner's brief.

[17] In December 1988, an 11.5% share of SERI's 90% share of Grand Gulf I was sold to investors and leased back.

C. Characteristics of the "System" [JA-62-63; JA-67-82]

The Middle South "system" operates as an electric power pool, in which the transmission facilities of the individual companies are interconnected. The generating units are centrally-dispatched and controlled. Decisions to build electric generation plants have been made based on the needs of all the operating companies. However, each generation plant has been built, owned and operated by each company individually — with the recent exception of Grand Gulf. Petitioner misportrays each operating company as sharing equally the total system power costs.[18] Rather, each operating company's decision in selecting power sources principally determines its costs, and there is, and has been, a disparity in total power costs among the companies. (JA-78.) NOPSI has had the highest costs on the "system" for almost 20 years. (*Id.*)[19]

D. Grand Gulf [JA-82-88]

NOPSI became involved in Grand Gulf in 1974 when it entered into the first of a series of agreements to guarantee certain

[18] Petitioner's brief redacts language in the *MP&L* decision, 108 S. Ct. at 2431, slip op. at 2, so as to say that the system agreements "*equaliz[e]* cost imbalances," (Pet. Br. at 5; emphasis added) which is not true, as described in the next footnote.

[19] The system agreements allocate responsibility to pay for and partially equalize *excess capacity* costs (along with a capacity entitlement), but they do *not* equalize the companies' total power costs. Moreover, the cost of all the power plants is not divided proportionately. Rather, a company pays *principally* for the plants *it* builds (or contracts for) and *may* at intervals pay for a portion of the *excess capacity* of certain plants built by others to the extent it is deemed "short" under the terms of the system agreement. The operation of the 1973 system agreement and the resulting costs are set forth at JA-73 to JA-80. Changes reflected in the 1982 system agreement are at JA-100. In the FERC's allocation decision there were some unclear and conflicting recitals regarding the terms of these agreements, and they, *inter alia*, are among the matters being considered in the appeal now pending elsewhere. (*See* n.21 *infra*.)

Also, petitioner quotes language of the *MP&L* decision to the effect that the 1982 System Agreement was "designed to ensure that each company contribute proportionately to the total costs of generating power on the system." (Pet. Br. at 5, n.5; *MP&L*, 108 S. Ct. at 2433, slip op. at 5.) That language, not necessary to the *MP&L* decision, does not accurately describe the system agreement, which allocates the cost of excess capacity to "short" companies, but does not prescribe "proportionate contributions" to the total cost of power. (*See* JA-73-77; JA-99-100.)

indebtedness for the construction of the plant and agreed to pay for indeterminate amounts of its output. (JA-85-88.) NOPSI did not seek authorization to enter into these agreements and did not, for six years, inform the Council of its commitments.

As construction of Grand Gulf went forward, certain events unfolded, summarized as follows. First, other companies, but not NOPSI, made commitments to diversify fuel supply through the acquisition of interests in coal-fired generation. (JA-88-91.) Second, the projected need of NOPSI and other companies for additional generating capacity decreased. (JA-81.) Third, nuclear plant construction costs increased sharply, driven primarily by concerns over safety. Moreover, new econometric studies revealed their real rate of increase to be even sharper. (JA-92-93.) Finally, in March 1979 an accident of unanticipated nature occurred at the Three Mile Island ("TMI") nuclear plant that precipitated a national inquiry and had major additional cost implications for the unfinished Grand Gulf project. (JA-94-95; JA-145-148.)

In January 1980, after the TMI incident, with the economics of Grand Gulf worsening, NOPSI's management inexplicably agreed to take a large fixed share of Grand Gulf (as well as of Grand Gulf II) — 29.8% of the MSE share, although NOPSI had only 9% of system load. (JA-95-100.) In 1985, the FERC found that NOPSI's management had agreed to an unreasonable share and reduced it to 17%.[20]

E. 1980 Hearings Before the Council [JA-101-102]

In May 1980, NOPSI sought Council approval of a "capacity adjustment clause" to authorize automatic pass-through of Grand Gulf costs when NOPSI began incurring them and informed the Council for the first time of NOPSI's obligations. NOPSI portrayed the proposal as enabling it to pass through "benefits" to the ratepayers. (JA-101.) Under oath, NOPSI's president, pressed regarding the supposed "benefits" and NOPSI's commit-

[20] *Middle South Energy, Inc.*, 31 FERC ¶ 61,305, *aff'd*, 32 FERC ¶ 61,425 (1985). New Orleans intervened in the FERC proceedings and contended successfully that the amount agreed to by NOPSI was improper, but unsuccessfully sought to have the amount set at 9%.

ting to the project without a public hearing, twice volunteered that NOPSI had the option of selling the capacity to other utilities:

> If it is in the wisdom of this Council that it is not appropriate for New Orleans Public Service to participate in this agreement . . . then NOPSI has the option of selling the capacity and marketing it which, we think will be a very attractive commodity to other electric utilities who will view this as very cheap, reliable power for the future.

(JA-102); and later in similar context, "[W]e will have the option of selling this unit and our portion of it to some other buyer." (*Id.*)

F. FERC Proceedings [JA-54-59; JA-103-109]

On June 18, 1982, SERI (*i.e.*, MSE) filed with the FERC the Unit Power Sales Agreement which reflected the shares of Grand Gulf cost responsibility to which the operating companies had agreed. (FERC No. ER82-616-000.) The issue posed was the proper allocation of cost responsibility. The prudence of the MSU companies' investing in, or the construction or completion of Grand Gulf was not raised. At the outset, Administrative Judge Liebman made clear that he did not intend to intrude upon possible retail issues regarding the responsibilities of the individual operating companies, twice stating, "I'm not getting into that," *Middle South Energy, Inc.*, FERC No. ER82-616-000, Transcript, Mar. 14, 1983 at 228 (*see* JA-56), and at the close of the dialogue, resisted being drawn into precluding state prudence reviews. *Id.* at 248 (JA-56-57). NOPSI did not participate in the proceeding until March 2, 1984, after the close of the hearings and evidentiary record.

A second case, No. ER82-483-000, was initiated on April 30, 1982 by the filing of the amended Middle South 1982 System Agreement that governs aspects of the planning of generation and transmission facilities and sales on the system. The issue posed was the allocation of the costs of generation. *Middle South Serv., Inc.*, 30 FERC ¶ 63,030, at 65,120 (1985).

The FERC issued a single order, Opinion No. 234 (later affirmed in Opinion No. 234-A), covering both cases. It held that the allocation of Grand Gulf costs agreed upon was unreasonable

and ordered a different allocation. As indicated, the 29.8% share agreed to by NOPSI was reduced to 17%. *Middle South Energy, Inc.*, 31 FERC ¶ 61,305, *aff'd*, 32 FERC ¶ 61,425 (1985).

Establishment of wholesale rates followed from the application of that formula to the costs of the project. The FERC declined to make a determination as to how such costs should be recovered in retail rates and did not order state regulators to refrain from conducting retail hearings and investigations. Instead, the FERC acknowledged the traditional role of the states in retail rate regulation, 31 FERC ¶ 61,305, at 61,951, and concluded that "the basic nature of regulatory control retained by the states under previous System Agreements remains unchanged." *Id.* at 61,952.[21]

The FERC's Acting Chairman confirmed in Congressional testimony that FERC did not determine any prudence issue relating to the operating companies and that:

> [T]he Commission has taken the position that the prudence of a party as the *purchaser* in an individual unit sale transaction is not generally within the scope of the issues considered in reviewing the rates and terms for the jurisdictional *sale* of power.[22]

G. NOPSI Rate Application and the Filing of "*NOPSI I*" [JA-27-29]

On May 17, 1985, two days after the Council reacquired regulatory authority from the LPSC (n.14 *supra*), NOPSI filed an application for a retail rate increase to reflect its Grand Gulf costs (JA-27). The Council promptly established filing requirements, and initiated proceedings to determine retail issues, including

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[21] The FERC's decision was appealed. The court remanded the case for reconsideration of the allocation issue. *See Mississippi Indus. v. FERC*, 822 F.2d 1104, 1105 (D.C. Cir.), *cert. denied*, 108 S. Ct. 500 (1987). On November 30, 1987, the FERC issued Opinion No. 292 in which it reaffirmed its prior allocation, *System Energy Resources, Inc.*, 41 FERC ¶ 61,238 (1987), which presently is on appeal to the District of Columbia Circuit. *City of New Orleans v. FERC*, No. 88-1062 (D.C. Cir. filed Jan. 29, 1988).

[22] *Powerplant Costs: Hearing Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce*, 99th Cong., 2d Sess. 21 (1986) (statement of Anthony Sousa, Acting Chairman, FERC).

phase-in plans, other forms of rate moderation, allocation among customer classes, and, later, prudence. (JA-21.) To deal with financial needs during its deliberations, the Council on July 25, 1985 invited NOPSI to file for interim rate relief. (JA-27.)

NOPSI sought no such interim relief, but instead commenced *NOPSI I* on August 1, 1985, seeking an immediate cost pass-through and damages of $1 billion from the Council members. The district court took testimony regarding supposed irreparable injury, but rejected NOPSI's position and directed NOPSI to seek interim rate relief from the Council. NOPSI did so on August 19, 1985. The government's brief states that the Council "denied NOPSI's request for interim rate relief" (p. 5), but this is misleading. On September 5, 1985, the Council passed Resolution R-85-526 (a) granting NOPSI $28.3 million in interim relief; (b) providing for recovery of full relief, as finally determined, for the period of deliberation; and (c) inviting NOPSI to seek additional interim relief as necessary. The Council determined that NOPSI would be maintained in a positive cash position through March 1986. (JA-28.) NOPSI never sought additional interim relief. After *NOPSI I* was dismissed on September 16, 1985, NOPSI made a partial submission of its refiled application on September 30, 1985, two weeks overdue, and completed its submission on October 11, 1985. (JA-28-29.)

The Court of Appeals initially reversed the district court, 782 F.2d 1236, but withheld its mandate, requested further briefing, and on September 2, 1986, concluded that "the district court's decision to abstain on the instant facts was a proper exercise of discretion." 798 F.2d 858, 864. It stated:

> [T]he regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise. The regulatory scheme is complex. In addition, the Louisiana state courts are fully able to address NOPSI's complaints about Council actions: appeals from Council orders are to be filed with the Civil District Court for the Parish of Orleans. Significantly, NOPSI has not denied that adequate state court remedies exist. That the state courts often capably address claims such as that raised by

> NOPSI is apparent from the number of state court cases upon which NOPSI relies to prove its preemption claim substantial. Nor would federal abstention foreclose the United States Supreme Court from entertaining NOPSI's preemption claim should it wind its way up through the state courts, as is demonstrated by the path of the recent *Nantahala* case.

Id. at 862. NOPSI's petition for *certiorari* was denied. 481 U.S. 1023 (1987).

H. Initiation of the Prudence Proceeding and "*NOPSI II*" [JA-29-32]

On October 10, 1985, the Council initiated an investigation of NOPSI's prudence with respect to Grand Gulf I as a part of the rate proceeding. (Res. No. R-85-636.) The resolution proposed to investigate several aspects of NOPSI's relationship to Grand Gulf "for the purpose of determining what portion, if any, of NOPSI's Grand Gulf I expense shall be assumed by its shareholders," including, *inter alia*, NOPSI's "efforts to minimize its total cost exposure for the purchase," and Grand Gulf's "impact on its other power supply opportunities." It declared that, "The Council will not seek to invalidate any of the agreements surrounding Grand Gulf 1 or to order NOPSI to pay MSE a rate other than that approved by the FERC." Res. No. 85-636 at 4. (JA-113-114.)

Although the resolution requested that NOPSI respond to evidentiary questions by November 18, 1985, NOPSI did not respond or discuss any concerns. (JA-29.) Instead, it initiated its "*NOPSI II*" action against the Council on November 14, 1985, which was dismissed as previously described (*supra* at p. 3).[23]

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[23] Regrettably, petitioner incorrectly asserts that the Council's order disallowing $135 million "violated its representation in the Fifth Circuit in *NOPSI II*" (*see* Pet. Br. at 9), improperly taking advantage of a verb tense error in that court's opinion, which stated that the Council represented in oral argument that it "was looking into the possibility that NOPSI could make 'off-system' sales," 833 F.2d at 586; whereas, in fact, it had stated that it was looking into such sales in the 1979-80 period. Motions by both parties ensued and respondent noted that its position be verified by reference to its brief, the official recording of argument and a press account. NOPSI seemingly conceded that the court's opinion might be corrected "as perhaps it should be." NOPSI's Memorandum in Response to Motion to Amend or Correct Judgment, January 7, 1988 at 4. The Fifth Circuit

I. Settlement of the Rate Case

On March 20, 1986, after the Fifth Circuit's first decision in *NOPSI I* was rendered, the Council and NOPSI reached a settlement, embodied in Council Resolution R-86-112. The settlement provided, *inter alia*, that NOPSI's shareholders would absorb $51.2 million of Grand Gulf costs and that all the remaining costs would be passed on to retail ratepayers under a "phase in" plan of 8 or 9 years designed to moderate the adverse effects of "rate shock." The Settlement Resolution provided that the Council could continue its prudence investigation. (JA-185.)

Petitioner recites that "[t]o obtain any rate relief at all," it was "*forced* to agree to a settlement" (Pet. Br. at 3) (emphasis added), but this is utterly untenable. Petitioner fails to mention, *inter alia*, that the Council had provided, and offered further, interim relief to NOPSI; that the district court had found that the Council was trying to maintain NOPSI in a positive cash position; that *all* the other operating companies reached local settlements involving phase-ins and, in the case of the two largest companies, major cost absorptions;[24] that NOPSI itself proposed the settlement and that NOPSI's President at a public hearing complimented the Council on the settlement efforts (Council No. CD85-1, Transcript, Mar. 20, 1986 at 7-8); and that the prudence inquiry did not delay the settlement or the rate increase, but rather was left to follow its own course. (JA-185.) NOPSI has never challenged the propriety of the settlement in any legal action.

J. The Prudence Inquiry

The prudence inquiry was conducted in three parts. The first, dealing primarily with substantive questions, involved numerous depositions followed by the submission of testimony in March 1986 and evidentiary hearings in April 1986. (JA-22.) In May 1986, the Council set additional discovery, testimony and hearings for the

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declined NOPSI's motion to rehear and did not amend its opinion. By abstaining in *NOPSI III*, the Fifth Circuit indicated that there was no basis to NOPSI's claim that *NOPSI II*'s dismissal was based on any unfulfilled representation by the Council.

[24] (*See* JA-53 n.31.) AP&L absorbed 20% of its Grand Gulf costs. LP&L agreed to absorb 18% of such costs. It is *not* necessarily in a utility's best interest that all costs be passed through. *See* n.4 *supra*.

second phase, regarding the economic impact of possible remedies if imprudence were ultimately found. (*Id.*) These were held in October 1986. The passage of the Tax Reform Act required a third phase for reconsideration of economic issues, and a special hearing for this purpose, after additional discovery, was held in February 1987. (JA-22.) The Hearing Examiner transmitted the certified record to the Council on April 16, 1987. (*Id.*)

K. The Rate Order and "*NOPSI III*"

After deliberation, public hearings and unfruitful settlement discussions with NOPSI (JA-22), the Council issued its Rate Order on February 4, 1988,[25] reducing NOPSI's aggregate rate increase over time to reflect a disallowance of $135 million (JA-209-212),[26] which was based on overwhelming evidence of managemental indifference and reflected management's failure to realize offsetting sales of power. The Rate Order did not alter the FERC's allocation to NOPSI for any purpose (JA-23) and did not shift Grand Gulf costs to ratepayers elsewhere. The Council limited the disallowance and implemented it gradually, in the form of reduced rate increases over time. (JA-211.) The Rate Order also addressed the preemption arguments raised by NOPSI there and determined that a number of areas were beyond its jurisdiction, but that risk reduction at the retail level was not. (JA-52-61; JA-122; JA-175.)

NOPSI immediately commenced this action. The district court, noting that this was NOPSI's "third trip to this court," abstained, stating:

> The Rate Order does not ostensibly question NOPSI's FERC-allocated Grand Gulf I costs . . . . Rather, the

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[25] NOPSI's brief improperly implies that the Council waited for the Fifth Circuit's decision in *NOPSI II* before issuing its Rate Order (Pet. Br. at 9 n.12). In fact, the Council withheld decision because it and NOPSI were engaged in settlement negotiations which continued into 1988. (JA-22.) These matters are reflected in correspondence with NOPSI that can be lodged with the Court if necessary. Also, a draft order had been prepared in October 1987, but it was not adopted. There were numerous modifications before an order was issued by the Council in February 1988.

[26] The government inaccurately states that $135 million was ordered deducted from NOPSI's "rate base." (Gov't Br. at 8.) Grand Gulf involves purchased power and is not a "rate base" item.

> Council determined that as a result of NOPSI's deficient and uncritical oversight of the Grand Gulf I project and its failure to realistically assess its heightened risk exposure in the wake of the Three-Mile Island incident, NOPSI imprudently failed to reduce the risk of its Grand Gulf commitment in 1979 and 1980 by selling a portion of its share of the nuclear power off-system and further did not even attempt to ascertain whether off-system sales could be accomplished notwithstanding its President's assurances to the Council that such sales were possible.

(Cert. App. 24A.)

* * *

> Exercise of jurisdiction at this stage would preclude the state court from assessing and formulating state policy .... [T]he Council's Rate Order is subject to review in Louisiana state court .... Unlike NOPSI, this court does not believe that the Louisiana courts will dispose of federal issues 'from a biased perspective.'

(*Id.* at 27A-28A.)

The Fifth Circuit affirmed on grounds detailed in argument *infra*. NOPSI's petition for *certiorari* followed. The state court actions have previously been described.

SUMMARY OF ARGUMENT

The district court was entirely correct in abstaining from exercising jurisdiction to enjoin a state utility rate order that involved clear state interests of the "most important" kind and a lawful state effort to address rates and practices within its jurisdiction. The state had a right to attempt to explore and define the responsibility of prudent utility management to pursue options available to it to reduce power supply risks, free of disruptive federal litigation, where the alleged federal limitation raised a debate in complicated circumstances over what implied preemptive effects should be imputed to a FERC order. While petitioner and the government press the Court to decide prematurely that the regulator's action had been categorically preempted here, no

state court has provided an authoritative ruling on the regulatory matter in question; and no court, state or federal, reviewing this matter has shared petitioner's view of the nature of the preemption issue. This Court should not be drawn into making a substantive preemption decision without requiring the very process of mediation and development by the state courts that its own abstention decisions require.

Petitioner refused to take its case to the state courts, though explicitly directed years ago to do so, with the result that the "delays" and the implausible "irreparable injury" of which petitioner complains are self-inflicted. To this day, petitioner has not raised any claim of irreparable injury in a state court; it is incredible that any company actually suffering irreparable injury would fail to do so. Instead, petitioner spent its efforts successfully to drain state regulatory resources and to disrupt state regulatory review by filing three federal lawsuits and 20 motions.

Were the Court to become entangled in the preemption issue prematurely, or to allow petitioner to ignore the state courts, it would rip a gaping hole in its own abstention doctrine as established in the *Younger-Huffman-Pennzoil* and *Burford* lines of cases. It would create a special access rule for electric utilities even though, for at least half a century, *every* act of Congress in this area — the Federal Power Act; the Public Utility Holding Company Act; the Anti-Injunction Act; and the Johnson Act — has been aimed at *protecting* state regulatory jurisdiction and *curtailing* utilities' attempts to use the lower federal courts to interfere with state regulation.

Here, *every* requirement of this Court's established abstention tests was met and exceeded: (1) state court actions were actually pending; (2) state utility regulation is one of the "most important," "sensitive," and "paramount" local concerns; (3) the opportunity to raise federal challenges in state proceedings was uncontested; and (4) the proceeding involved the very archetype of a complex regulatory system. Even if the Council's regulatory order were erroneous, the state maintained an important interest in developing its own system of review and making its own regulatory institutions responsible, instead of being superintended by the lower federal courts. Moreover, there are very substantial

efficiencies here in channeling review through the state system, including avoidance of the duplication and "churning" that results when there are two litigation tracks that the utility can use to disrupt state regulation.

Petitioner's and the government's arguments rest on the biased premise that the federal courts will act *faster* and *righter* than the state courts — which cannot withstand scrutiny and is contradicted by empirical evidence. The government's argument that the state courts cannot be relied upon in "multistate" disputes is irrelevant, since this is not a multistate dispute, and the argument is otherwise insupportable.

Petitioner has virtually no support in the case law, which, with near uniformity, supports the rule that if abstention is otherwise required, as here, a federal court may refuse to abstain only when (1) preemption is "facial" or "readily apparent"; or (2) the state has established authoritative, unambiguous policy on the very matter in issue. Even then, federal interference is not *required* because "facial invalidity" is not itself an "exceptional circumstance" justifying interference. There are other sound reasons to allow a state to "set its own house in order," particularly in an area as sensitive as local utility regulation.

Petitioner's arguments rest upon a gross misportrayal of the Federal Power Act, which was extremely protective of state regulation and was passed only after revisions "removed every encroachment upon the authority of the states" and added language to "prevent the expansion of federal authority." Under established tests, there was no preemption here — much less the "facial" or "readily apparent" variety necessary to justify interference. The Council acted in an area which Congress did not either specifically preempt or occupy as a field, and the issue thus requires a plenary "conflict-pre-emption analysis." This analysis must be applied "sensitively" in order to "prevent the diminution of the role Congress reserved to the states." This approach alone presents a compelling case for deference to state courts.

Even if further analysis were appropriate, there is no ostensible preemption. The Rate Order sets only retail rates; accepts as a "given" the FERC-allocated share; imposes a disallowance only on the basis of management's failure to realize savings

through other transactions; does not stand as an obstacle to the FERC's allocation of plant costs or the utility's payment of them; and passes no costs to the ratepayers of other states. It rests on overwhelming evidence of bad management at the retail level, and there is no federal purpose to insulate utility investors from the risks of such management.

NOPSI's reliance on the *Nantahala* and *MP&L* cases is misplaced. In both cases, the local regulator sought to alter the FERC's allocation to the utility for purposes of retail ratemaking. Both cases, in addition, turned on the fact that the utility had virtually no choice with respect to the power costs in issue. Here, however, petitioner had the option to pursue other transactions of the kind that it told the Council it could make, as established by the evidence. Moreover, the issue of management's prudence in this instance could not have been litigated at the FERC.

The merits of NOPSI's preemption claim are now before the state court, and the record there includes new arguments by NOPSI regarding preemption never made in the courts below. The entire case should be decided in state courts, without further disruption through collateral federal proceedings, before this Court is called upon to act, if there is need that it do so.

ARGUMENT

I. ABSTENTION WAS REQUIRED UNDER ESTABLISHED PRINCIPLES

A. The Tests Established by This Court Compelled Abstention Here

Petitioner's "Question Presented" misportrays this case when it asks whether abstention was appropriate where "explicit orders" of the FERC preempted local authorities from determining "the very matters FERC has decided." (Pet. Br. at i.) There is nothing "explicit" in the FERC's orders that addressed or "decided" an operating company management's prudence for failure to make use of available risk-reduction measures. Instead, this case involves *clear* state interests, a debate over what implied effects should be imputed to a FERC order, and the question

whether to encourage a duplicative litigation track designed to disrupt state proceedings.

Louisiana has an undeniable substantive interest in regulating the rates and practices of domestic utilities. That interest was expressed here, at the regulatory level, in the principle that prudent management may not "sit on its hands" in relation to the growing risk of a power commitment when there where other options available. Petitioner argues that the FERC's order preemptively stripped management of any such responsibility, and, as a corollary, that the retail regulator is powerless, whatever the facts, to act in such a situation.

Petitioner's extensive preemption argument, however, gets well ahead of the issue here — whether the Court should undermine its own abstention cases by undertaking a complicated preemption review without requiring that the case be first developed in the state adjudicatory system. The issue is here without *any* state court decision on the merits. This situation has arisen because, despite this Court's decisions and federal court rulings addressed specifically to petitioner, it is determined to hold itself above state authority and to use the federal courts to disrupt state review. The alleged "delays" that NOPSI deplores here are self-inflicted. Similarly, NOPSI's implausible claim that it is suffering "irreparable injury" has not been squarely adjudicated because NOPSI has refused to raise the issue in state court, which is entirely capable of responding to any urgent need for relief. *See Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 15 (1987).

To credit petitioner's position would rip a hole in a virtually unbroken line of decisions underscoring the importance of a federal court's abstaining from interfering with the state adjudicatory system, *especially* when it is claimed that federal constitutional or statutory limitations preclude state action.[27] The abstention doctrines are not "rigid pigeonholes into which federal courts must try to fit cases," but rather reflect a "complex of considerations" designed to "soften the tensions inherent" in the

[27] Indeed, in instances where there is *no* clash between federal statutory or constitutional interests and state interests, such as when a federal court decides state law issues in the exercise of its diversity jurisdiction, there is ordinarily *no* basis for abstention. *County of Allegheny v. Frank Mashuda Co.*, 360 U.S. 185, 187-89 (1959).

federal-state system. *Pennzoil*, 481 U.S. at 12 n.9, and they rest upon either "comity" *or* the avoidance of unnecessary or "advisory" constitutional determinations. *Ohio Bureau of Employment Serv. v. Hodory*, 431 U.S. 471, 479 (1977).

The core of "comity" is "the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways." *Younger v. Harris*, 401 U.S. 37, 44 (1971). It envisions a sensitivity to, and mediation of, the legitimate interests of *both* State and National Governments. The insistence of the Court that these principles be followed is reflected in the language that:

> [I]t has been perfectly natural for our cases to repeat time and time again that the *normal* thing to do when federal courts are asked to enjoin pending proceedings in state courts is not to issue such injunctions.

Id. at 45 (emphasis added), and this language has itself been regularly repeated. *See, e.g., Ohio Civil Rights Comm'n v. Dayton Christian Schools*, 477 U.S. 619, 627 (1986). It is basic that state courts can be relied upon, equally with the lower federal courts, to decide federal issues impinging upon state interests. *Steffel v. Thompson*, 415 U.S. 452 (1974).

The principal doctrine founded on comity is that expressed in *Younger* and its progeny, particularly *Huffman v. Pursue, Ltd.*, 420 U.S. 592 (1975), and *Pennzoil*, which reflect "strong policies counseling against the exercise of '. . . jurisdiction," *Ohio Civil Rights Comm'n*, 477 U.S. at 626, and *require* abstention if the following factors are present: (1) there is an "on-going state judicial proceeding," a phrase which includes an administrative proceeding subject to state judicial review; (2) the proceeding implicates an important state interest; and (3) there is an adequate opportunity in the state proceedings to raise federally-based challenges. *Middlesex County Ethics Comm. v. Garden State Bar Ass'n*, 457 U.S. 423, 432 (1982). The court is required to abstain unless (a) there is a specific showing of bad faith or harassment; (b) the case turns on an unsalvageably invalid state statute;[28] or (c) there

[28] The statute must be entirely incapable of being applied consistently with federal law, under any circumstances. *Watson v. Buck*, 313 U.S. 387, 400-02 (1941).

are "extraordinary circumstances" — *i.e.*, those that "render the state court incapable of fairly and fully adjudicating the federal issues before it." *Moore v. Sims*, 442 U.S. 415, 433 (1979) (quoting *Kugler v. Helfant*, 421 U.S. 112, 124-25 (1975)). None of these exceptions is present here.

The *Burford*[29] doctrine is a special case of comity-based abstention that applies when a complex state regulatory matter is involved and the state adjudicatory system is open to federal claims. The presence of a complex regulatory scheme makes it probable that federal interference would disrupt the development of a reasoned solution and state regulatory law.[30] Abstention is required even if no state proceeding has been initiated, and even if there is no state law "question" framed as such. *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800, 814-15 (1976). State utility regulation is the archetype of a complex regulatory system, and its presence implicates the *Burford* doctrine, even when, as here, *Younger* is also fully applicable.[31]

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[29] *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943).

[30] Petitioner contends that *Burford* requires that there be a specialized state court for review of regulatory decisions. (NOPSI Br. at 26 n.28.) In applying *Burford*, the courts of appeals generally have not deemed this circumstance to constitute a requirement. *See, e.g., Corcoran v. Andra Ins. Co.*, 842 F.2d 31 (2d Cir. 1988); *Meredith v. Talbot County*, 828 F.2d 228 (4th Cir. 1987); *Robert-Gay Energy Enter. v. State Corp. Comm'n*, 753 F.2d 857 (10th Cir. 1985); *Browning-Ferris, Inc. v. Baltimore County*, 774 F.2d 77 (4th Cir. 1985).

[31] *See, e.g., Aluminum Co. of Am. v. Utilities Comm'n*, 713 F.2d 1024 (4th Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984). The government (Gov't Br. at 21 n.15) would apparently have a different abstention rule apply where the state ratemaking agency is elected. A good number of state utility commissions are elected; others are appointed by the governor, some with and some without legislative concurrence, all with limited terms. No different abstention rules should apply, any more than to state courts, which are both elected and appointed.

The government also suggests that this Court should show "concern" because the Council has also been negotiating with NOPSI toward possible municipalization of electric supply, a legitimate local function and hardly a basis for the imputation of bias. Suggestions of so serious a nature are inappropriate for appellate footnotes; bias must be proved. *Gibson v. Berryhill*, 411 U.S. 564 (1973). If the Council's findings are not supported by the evidence, there is a state court remedy for it.

In the instant case, the requirements of each doctrine are met and exceeded: (1) the establishment of local utility rates and policies is a very "sensitive" matter of extreme local concern;[32] (2) there are pending state proceedings; *both* the state court suits themselves and the Council's completed regulatory proceeding meet this test because there was an opportunity to seek state court review of the latter proceeding;[33] (3) petitioner's federal claims can be raised and adjudicated in the Louisiana courts;[34] and (4) state utility regulation is the very model of complex and specialized regulation.[35]

State court review here was clearly the appropriate path. The state had an interest in developing an authoritative statement of regulatory law. This might result in reshaping the responsibility of utility managers with respect to risk reduction, a different remedy, different proof requirements, or a declaration that there is no responsibility at all. The very fact that the FERC set binding allocations presented the problem of how the state should deal with legitimate local concerns, including utility accountability and risk-management practices, in a difficult situation. The state should be given the opportunity to "mediate" competing state and

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[32] It is "one of the most important of the functions traditionally associated with the police power of the States." *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983). "[T]he regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise." *NOPSI I*, 798 F.2d at 862; "[A] state's regulation of its public utilities is a sensitive area of social policy into which a federal court should not intrude unnecessarily." *International Bhd. of Elec. Workers v. Public Serv. Comm'n*, 614 F.2d 206, 212 (9th Cir. 1980).

[33] *Huffman v. Pursue, Ltd.*, 420 U.S. at 607; *see Middlesex County Ethics Comm.*, 457 U.S. 423.

[34] This is uncontested, and state court suits encompassing NOPSI's federal claims are pending. Pursuant to Section 4-1604 of the New Orleans Home Rule Charter, appeal lies from an order of the Council. Articles 3601 and 3602 of the Louisiana Code of Civil Procedure provide for rapid hearings on injunctions.

[35] Here, for example, both the analyses of the costs of alternative power sources and the nature of the options available to NOPSI at particular points in time, issues basic to the prudence inquiry, are complex matters that involve specialized expertise. (*See, e.g.*, JA-156-159.) Moreover, the development of possible remedies for imprudence involved complex economic and rate analyses peculiar to utility regulation. (*See, e.g.*, JA-179-209.)

federal interests here and not be prevented from the "informed evolution of state policy." *Moore v. Sims*, 442 U.S. at 429; *Trainor v. Hernandez*, 431 U.S. at 445. Moreover, abstention would avoid confronting, as a basis for decision, the lowest echelon expression of state "policy," and it removes all doubts about what the state would and could do if permitted to act.

Abstention here would also permit an authoritative review of the state administrative record (under state rules requiring evidential support and rational judgments), in light of state policy and other state issues, at the same time and in the same forum that the federal claims are being considered. This is far more efficient, less disruptive, and avoids the problem faced here (*see* Pet. Br. at 11-12) of the utility's denigrating the substance of the state's decision under the pretense of arguing jurisdiction.

It is important to discourage two litigation tracks. Otherwise, it is inevitable that utilities will strain to involve the lower federal courts. The state then faces the duplicative task of trying to implement its own policies while fighting federal litigation, *see Trainor*, 431 U.S. at 445, with disruption and wasted motion. This dispute alone resulted in *three* separate federal lawsuits filed by NOPSI. The Council has responded to *twenty* separate federal motions – for, *e.g.*, expedition, interim relief, rehearings and withdrawal of mandates, all of which have consumed both regulatory and judicial resources; most of which were denied; and some of which NOPSI must concede to have been of questionable merit[36] – as well as to state applications. The utility can thus "churn" litigation as a means of depleting regulatory resources.

Federal interference also undermines the state's interest in developing a system of review competent to vindicate federal rights arising in matters involving its own regulatory bodies, *see Huffman* , 420 U.S. at 592, 604, 609; *Juidice v. Vail*, 430 U.S. 327, 335 (1977), and it reflects negatively on the state, damaging the development of responsibility and accountability within the state system. *Trainor*, 431 U.S. at 445-446.

[36] For example, petitioner now apparently concedes that it was a "legitimate state retail ratemaking function" for the Council to hold proceedings on rate moderation issues such as the phasing-in of Grand Gulf expenses (Pet. Br. at 27), while in *NOPSI I* it had contended it was entitled to an immediate and full pass-through of such expenses.

Petitioner's and the government's urgings as to the need to "vindicate" federal rights and avoid "delay" and "harm" rest precisely on the biased, negative premise that lower federal courts will act *faster* and *righter* than state courts, which is unsupportable. State courts originally were relied upon exclusively to hear these federal matters, and have shared jurisdiction co-equally with the lower federal courts since 1875. *See Alabama Pub. Serv. Comm'n v. Southern Ry. Co.*, 341 U.S. 341, 355 (1951) (Frankfurter, J., concurring). The state courts have shown themselves responsible in overturning the actions of state regulators on the basis of federal statutory and constitutional limitations.[37] They have, in fact, been responsible for the development of the "*Narragansett* Rule," the chief preemption doctrine in utility rate law.[38] The Louisiana courts in particular have acted responsibly in enforcing federal law in the regulatory area,[39] and have otherwise exercised close supervision of state utility regulators.[40]

These real-world facts wholly undercut the government's declaration that "federal preemption claims" turn solely on an "understanding of a complex federal regulatory scheme," and do

[37] *See, e.g., Washington Gas Light Co. v. Public Serv. Comm'n*, 508 A.2d 930, 936 (App. D.C. 1986); *Northern States Power Co. v. Minnesota Pub. Util. Comm'n*, 344 N.W.2d 374, 378 (Minn.), *cert. denied*, 467 U.S. 1256 (1984); *Eastern Edison Co. v. Department of Pub. Util.*, 446 N.E.2d 684, 689 (Mass. 1983); *Northern States Power Co. v. Hagen*, 314 N.W.2d 32, 38 (N.D. 1981); *United Gas Corp. v. Mississippi Pub. Serv. Comm'n*, 127 So. 2d 404, 420 (Miss. 1961).

[38] *Narragansett Elec. Co. v. Burke*, 381 A.2d 1358, 1362 (R.I. 1977), *cert. denied*, 435 U.S. 972 (1978); *Chicago v. Illinois Commerce Comm'n*, 150 N.E.2d 776, 781 (Ill. 1958); *Citizens Gas Users Ass'n v. Public Util. Comm'n*, 138 N.E.2d 383, 384 (Ohio 1956); *see also* cases cited *supra* note 37.

[39] *See, e.g., Louisiana-Nevada Transit Co. v. Fontenot*, 97 So. 2d 411, 414 (La. 1957) (state tax on interstate natural gas); *Louisiana Power & Light v. Louisiana Pub. Serv. Comm'n*, No. 292,026 (La. Civ. Dist. Ct. Oct. 9, 1985) (reversing failure to recognize FERC-approved costs); *Neuss, Hesslein & Co. v. Louisville & N. Ry. Co.*, 59 So. 2d 195, 198 (La. 1952); *Smith v. Delta Express, Inc.*, 359 So. 2d 1066, 1068 (La. Ct. App. 1978); *Bohrer Chem. Co. v. SAIA Motor Freight Lines*, 227 So. 2d 650, 651 (La. Ct. App. 1969); *Crowley Indus. Bag Co. v. Western Union Co.*, 204 So. 2d 725 (La. Ct. App.), *cert. denied*, 206 So. 2d 711 (1968).

[40] *See, e.g., Gulf States Util. Co. v. Louisiana Pub. Serv. Comm'n*, No. 325,224 (La. Civ. Dist. Ct. Feb. 18, 1988) (requiring LPSC to provide higher return to protect utility's financial stability).

not "present appropriate occasions for deference to state tribunals." (Gov't Br. at 22.) In addition, resolution of preemption claims in the electric utility area will depend on an understanding of *both* federal and state regulatory interests, including a complex *state* regulatory scheme, and the opportunity for "mediation" of the two.

There is more empirical evidence that refutes the government's bias. A recent comprehensive treatise on American constitutional law cites 48 important cases of this Court on preemption. Not only did *most* cases (26) follow a *state court path* to this Court, but also the state courts did *slightly better* (50% to 47%) than the lower federal courts in reaching the correct outcome on the issue of preemption.[41]

The government also urges that comity be discounted here because, it says, this is a "multistate" dispute, implying that bias will prevail because "a decision . . . of any one state . . . may have a corresponding direct adverse effect on" other states. (Gov't Br. at 20-21.) But this is *not* a multistate dispute; no other states have intervened; none has filed as *amicus* against respondent; the Rate Order did *not* shift costs to their ratepayers; the Council's remedy here was moderated so as to avoid even indirect effects. (JA-209-211.) Indeed, there are not even *substantive* recitals of adverse impact on other states' ratepayers in the complaint or in any of NOPSI's affidavits. (*See* n.3 *supra*.) Even if this *were* a multistate dispute, it would be just as important to give a state the opportunity to develop policy against the background of other states' interests as when other federal constraints are involved. The state courts should not be deemed less competent to interpret state policy or federal law because the Commerce Clause is involved, nor biased in doing so.

B. Petitioner Has No Support in the Case Law

Petitioner's discussion of abstention law gets off on the wrong foot by misportraying the opinion of the Fifth Circuit as "correctly" assuming "that the Council had no legitimate interest in the

[41] All preemption cases cited at pages 479-511 in Chapter 6 of Tribe, *American Constitutional Law* (2d ed. 1988) were reviewed to determine the lower court path and how the result reached compared to this Court's determination.

prudence investigation; that its Order is 'beyond the Council's . . . authority.'" (Pet. Br. at 3.) Instead, the Fifth Circuit said it would "assume" that the district court "thought" that it should abstain "*even if NOPSI were able to prove, as it alleges*," with "some" apparent evidential support, that the Rate Order improperly traps costs, was based upon factors that the state could not consider, and consequently was beyond the Council's authority. 850 F.2d at 1075; Cert. App. 11A (emphasis added).[42] Thus corrected, it is clear that the alleged preemption was *not* viewed as proven, "facial" or "readily apparent."[43]

This has been a pivotal distinction. All cases relied upon by petitioner can be reconciled by the rule that a federal court may refuse to abstain when (1) preemption is facial, direct or "readily apparent" and, of course, dispositive; *or* when (2) the state has already taken authoritative and unambiguous action on the very matter in issue. If either circumstance were present, deference to the state court would serve a diminished purpose — although such a determination should be made with great care, and there still would be a basis for discretion to abstain.[44]

In *Public Utility Commission of Ohio v. United Fuel Gas Co.*, 317 U.S. 456 (1943), upon which petitioner principally relies (Pet.

[42] Also, the Fifth Circuit did not say that the Council had no "legitimate interests" here. The Council and the state have compelling interests. NOPSI uses the quoted phrase to get extra mileage out of its circular and overly broad argument that if the state's substantive law is constrained by preemption, none of its interests are "legitimate."

[43] The Fifth Circuit also noted at another point that the facts of this case were different from the facts of *MP&L* (indeed, the factual differences are even greater than noted by the Fifth Circuit), but it apprehended that the language in the *MP&L* decision, though addressing a different set of facts, was broader. 850 F.2d at 1076; Cert. App. 13A.

[44] The Court has stated that the "*facial invalidity* of a statute *is not itself* an exceptional circumstance justifying federal interference with state criminal proceedings." *Huffman*, 420 U.S. at 602 (emphasis added). Even where there is apparent preemption, the state still would have an institutional interest in "setting its own house in order," through appellate review of its administrative agencies, whether or not an initial administrative order is determined to be erroneous — particularly in the area of utility regulation where the state has undeniable interests. *See id.* at 604 (state has institutional interest in overseeing trial court disposition of constitutional issues).

Br. at 24, 26, 32, 35), the state utility commission sought to set the rate for the *inter*state sale of gas from wholesaler to retailer — an act unquestionably beyond its authority, directly in conflict with the Natural Gas Act's grant to the Federal Power Commission of exclusive authority over such rates. *Id.* at 466-68. The *only* additional issue was whether the state would have been preempted *before* the Act was passed; but the Court did not reach the issue because the order, read in consonance with state law, did not assert jurisdiction to fix the rates during that period. *Id.* at 468. Even so, the Court stated that in "ordinary circumstances" it would have *abstained*, but noted the exceptional factor that the case had "already been too long in the federal courts" (*id.* at 462) — for *eight years*. *Id.* at 460 n.2.

Similarly, in *Public Utility Commission of California v. United States*, 355 U.S. 534 (1958) (Pet. Br. at 18, 24, 25), the "only question" was whether the state could constitutionally force the United States to submit to prior state review of its common carrier contracts, and the Court held that it was the "very essence" of supremacy that the state could not. *Id.* at 540, 544.

Identical analytically is *City of Chicago v. Atchison, T.& S.F. Ry. Co.*, 357 U.S. 77 (1958) (Pet. Br. at 24), where the city enacted an ordinance requiring the operator of transfer services in *inter*state commerce to seek a business license. Because the Interstate Commerce Act "authorized, if not actually required," the transfer services, 357 U.S. at 86, the Court found that the city was powerless to exercise such licensure. Abstention was urged only to determine that the ordinance applied to the particular operator. The Court declined to defer because the ordinance was virtually designed to apply to the operator; the city itself contended that it did; and there was no ambiguity. 357 U.S. at 80, 84.

An example of the second situation (where the state has already decided the matter in question) is found in *Schneidewind v. ANR Pipeline Co.*, 108 S. Ct. 1145 (1988), upon which NOPSI had relied in its petition for *certiorari* (Pet. at 10). There, the Court held that a Michigan statute requiring state approval of an interstate gas transportation company's securities issuance was preempted by the Natural Gas Act. Abstention was unnecessary because the state supreme court had already decided the matter

in question; in fact, *certiorari* was granted because of the conflict between the state decision and a federal one. 108 S. Ct. at 1150.

The lower court decisions cited by NOPSI are entirely consistent with decisional principles noted above. *Middle South Energy, Inc. v. Arkansas Pub. Serv. Comm'n*, 772 F.2d 404, 408, 411 (8th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986) (abstention inappropriate where the state commission proposed to void the very contract and allocation approved by FERC); *Kentucky W. Va. Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 791 F.2d 1111, 1113, 1114, 1118 (3d Cir. 1986) (no abstention; state policy already articulated by all three branches of the Pennsylvania government);[45] *American Elec. Power Co. v. Kentucky Pub. Serv. Comm'n*, 787 F.2d 588 (6th Cir. 1986), *cert. denied*, 481 U.S. 1023 (1987) (three separate opinions supporting abstention; issue was whether a utility, part of a multistate system, acted prudently in purchasing power from a higher-priced power pool; utility insisted that an interstate agreement required it to discontinue pool purchases and that the state could not even interpret the agreement); *Baggett v. Department of Professional Regulation*, 717 F.2d 521 (11th Cir. 1983) (no abstention where state proposed a disciplinary hearing regarding a marine pilot on an "enrolled vessel" within *exclusive* federal jurisdiction); *International Bhd. of Elec. Workers v. Public Serv. Comm'n*, 614 F.2d 206 (9th Cir. 1980) (petitioner omits to state that although abstention under *Burford* was denied, abstention under *Pullman* was upheld; authoritative analysis of state law was sought).

Two Fourth Circuit cases show how the decisional rules noted above are practically administered. In *Aluminum Co. of America v. Utilities Commission*, 713 F.2d 1024 (4th Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984), the court upheld abstention where, as here, the state commission had acted and the state courts were involved in review. 713 F.2d at 1029. The court held that to justify federal intervention, "whether the challenged state action con-

[45] State action was later found *not* preempted, *Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Comm'n*, 837 F.2d 600 (3d Cir.), *cert. denied*, 109 S. Ct. 365 (1988), but the state had been required to litigate the issue through the federal court system, and even further federal court litigation, encouraged by the initial decision not to abstain, has ensued.

flicts with federal law must be *readily discernable* from the pleadings" so that it can be determined that it "*clearly conflicts*" with "preemptive federal law." *Id.* at 1030 (emphasis added).[46] In contrast, the court ruled in *Appalachian Power Co. v. Public Service Commission*, 812 F.2d 898 (4th Cir. 1987), that abstention was unnecessary with regard to a state prudence inquiry involving an interstate transmission agreement where the inquiry involved the *identical* issues determined by the FERC — specifically noting the "identity of the inquiries" (*id.* at 904), FERC's exclusive authority with regard to interstate transmission (*id.* at 902), and that the utility had no way of avoiding the transmission arrangement (*id.* at 903), in finding a direct conflict.

The other cases of this Court from which petitioner and the government extract language out-of-context offer no support for their position. Two were brought under the Civil Rights Act, 28 U.S.C. § 1983 (1982), which is different because Congress specifically intended to alter "the relationship between the States and the Nation with respect to the protection of federally created rights" embraced by the statute. *Mitchum v. Foster*, 407 U.S. 225, 242 (1972). They are treated in the margin.[47]

[46] This dispute later reached this Court through the state court system as *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986).

[47] *McNeese v. Board of Educ.*, 373 U.S. 668 (1963). The only question to be litigated was the factual question of segregation, since section 1983 had created a specific private right of action on which relief could be granted regardless of state law. It was only in this context that a "skein of state law" was used. *Id.* at 674. Moreover, the state administrative remedy was found deficient. *Id.* at 674-75.

Zablocki v. Redhail, 434 U.S. 374 (1978), involved a section 1983 challenge to a statute prohibiting marriage, without prior state approval, of certain persons. There were no pending state court proceedings in which to challenge the statute. The Court noted that under section 1983, absent issues of state law that might affect the federal claims, an individual can sue in a federal forum. *Id.* at 380 n.5. *Compare Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1 (1987).

County of Allegheny v. Frank Mashuda, 360 U.S. 185 (1959). The case involved a federal court applying state law under its *diversity* jurisdiction, and there was *no* contention of any federal statutory or constitutional conflict. (*See* n.27 *supra.*) Moreover, the state itself required the particular action to be brought in a separate proceeding. *Id.* at 188, 195-96.

Colorado River Water Conservation Dist. v. United States, 424 U.S. 800 (1976). The ostensibly limiting langauge quoted (Pet. Br. at 20, 22; Gov't Br. at 10) was

Comparison with the recent *Pennzoil* decision compels abstention here. There, the federal plaintiff was faced with the requirement of a $13 billion state appeal bond that stood as an obstacle to its appeal of a state judgment, and it had incurred substantial adverse financial effects from the judgment. The underlying dispute arose from a commercial contract in which the state had no substantive interest. The federal plaintiff sued under section 1983, challenging state appeal bond procedures under the federal Constitution, and it had succeeded in establishing its claim in the lower federal courts. This Court held that those lower federal courts should not have interfered, noting that Texaco had not taken its federal claims to the Texas state courts and holding that Texas' interest in the administration of the process by which its judgments were obtained was sufficient to merit abstention. Here, the facts are far more compelling. A state-authorized regulator is a party; the subject matter lies in an area of recognized state concern; the Rate Order challenged seeks to articulate state utility regulatory policy; a complex regulatory system is involved; and there is no special statute relied upon, such as section 1983, that indicates Congressional intent to allow a separate federal action to proceed. To the contrary, there are only statutes indicating that Congress intended to curtail use of the federal courts in just these circumstances.

C. Other Arguments Advanced by Petitioner and the Government Regarding Abstention Here Are Without Merit

1. Louisiana Has Far More Than an "Adjudicatory" Interest

Petitioner's argument that the state's interest here is only "adjudicatory" draws inappropriately from the *Pennzoil* case, where the interest of the state was arguably only as "adjudicator of wholly private disputes." 481 U.S. at 30 n.2 (Stevens concurring). Simply put, Louisiana's interest is not so limited here.

actually a predicate for creating a *new* kind of non-interference doctrine — even *absent* the circumstances that would *require* abstention under the established doctrines. (Thus, although abstention from the exercise of federal jurisdiction is "an exception"; when the specified factors justifying abstention are present, it then becomes the "*normal*" thing to do. *Younger*, 401 U.S. at 45.)

Instead, (1) the state-authorized regulator is a party; (2) Louisiana has a Congressionally recognized interest in the subject matter area, involving retail rates and practices; (3) it has an important interest in the process of reviewing and, if need be, correcting the actions of a state-authorized regulator, particularly in the utility area; and (4) it has an interest in the specific issue of management standards, posed by the Rate Order. Even assuming *arguendo* the unlikely proposition that the present circumstances will ultimately be determined to allow no role for state substantive action, the state has an undeniable interest here in "setting its own house in order." *Ohio Bureau of Employment Serv.*, 431 U.S. at 480.

2. Abstention Is Not, as Petitioner Claims, a Charade

Petitioner's position that federal courts only defer in abstention cases if they *first* determine the very federal issue claimed to undermine the state's "substantive" interest (Pet. Br. at 33) is not supported by *Ohio Civil Rights Comm'n*. There the Court rejected the attack on the state's jurisdiction on the special ground that, "[W]e have repeatedly rejected the argument that a constitutional attack on state procedures themselves 'automatically vitiates the adequacy of those procedures for purposes of the *Younger-Huffman* line of cases.'" 477 U.S. at 628. Petitioner views the abstention process as essentially a charade — that is, the federal court first decides the merits of the federal issue to determine if the state has a "legitimate interest"; and only if it finds no federal bar does it defer to the state to adjudicate the very issue it has decided. This is not the law and it cannot be squared with the tenets of comity.

Instead, as indicated above, the courts undertake a very limited assessment of the alleged federal bar to determine whether it is "direct" or "facial" and dispositive, and once that hurdle is cleared, they route the case through the state court system for the several compelling reasons previously discussed. *See Aluminum Co. of Am.*, 713 F.2d at 1030.

3. There Clearly Is a State Proceeding Pending

The government's argument that the state proceedings now pending should not be deemed to satisfy the "ongoing proceeding" criterion — because, it says, the Council's lawsuit was "unnecessary," the consumers only complained about the Council's moderation, and NOPSI's own actions were defensive — misconceives the requirement. The Council's own ratemaking and prudence inquiry, even though complete, constitutes an "ongoing proceeding" because it is subject to state judicial review. Indeed, the availability of review qualified the administrative proceeding as an on-going judicial proceeding in the first place. *Ohio Civil Rights Comm'n*, 477 U.S. at 627. Even if no other suits had been brought, the right to appeal satisfies the criterion. "[W]e believe that a necessary concomitant of *Younger* is that a party in appellee's posture must exhaust his state appellate remedies before seeking relief in the District Court . . . ." *Huffman*, 420 U.S. at 608. Clearly, the state's interest in both substantive issues and institutional processes cannot be defined by a party's artificial narrowing of its pleadings or its failure to appeal.

D. Petitioner's Claims of Harm, Even of "Irreparable Harm," Do Not Undercut the Propriety of Abstention Here; Moreover, They Were Facially Implausible

Complaints of irreparable harm do not state a basis for refusal to abstain. Interim relief, if merited, was available in the state courts, purposely bypassed here by NOPSI. As the Court noted years ago:

> Appellee complains of irreparable injury resulting from the Commission order pending judicial review, but has not invoked the protective powers of the Alabama courts to direct the stay or supersedeas of a Commission order pending appeal.

Alabama Pub. Serv. Comm'n v. Southern Ry. Co., 341 U.S. at 349. Similarly in *Burford*, the Court noted that, "Texas courts can give fully as great relief, including temporary restraining orders, as the federal courts." 319 U.S. at 327. In order to obtain federal consideration of injunctive relief where abstention is otherwise warranted, a plaintiff must show not merely "irreparable harm" but also "extraordinary circumstances" which would render the state court incapable of providing immediate equitable relief, *see Moore*,

442 U.S. at 433, as well as threatened injury which is "great [and] immediate." *Id.* None of these tests was met here.

Despite being told by the federal courts here in 1985 to utilize the state court system, NOPSI sought no preliminary injunctive relief in state court. Even when directed in this very case by the federal courts to utilize the state courts for preliminary relief, NOPSI never presented its claim of irreparable harm there. NOPSI has apparently been more interested in demonstrating that it could not rely on state courts, than in seriously litigating its claims there.

Turning to the substance of NOPSI's claim, it first asserts that it was "forced" to agree to a settlement — a statement utterly contradicted by the surrounding facts and contemporary judicial determinations (*see* p. 12 *supra*). Moreover, NOPSI fails to mention that the settlement was reached in March 1986, *after* the *initial* decision by the Fifth Circuit in *NOPSI I* which held that *no* abstention was warranted and *before* it was amended. If anyone was "forced" then to settle by an abstention decision, it was the Council. Also, that abstention was the subject of *NOPSI I* and was held to be correct, and this Court denied review.

Turning to the alleged irreparable harm here, NOPSI does *not* contend that the amount of disallowance was irreparably lost. The disallowance was not a refund to ratepayers, but rather a reduction on NOPSI's books of its Grand Gulf deferrals that could be resurrected as an asset for future collection in rates. (R.7., Cecil Aff., p. 4.) Nor did NOPSI seriously claim that it would become bankrupt and not be able to continue the litigation. (It is still very much alive.) Rather, its claims were attenuated and turned on conflicting contentions as to how "financeable" the operating plan for NOPSI was, given the disallowance.

In this respect, the case came to the district court in an unusual posture. The Council itself took the extraordinary step of moderating any financial impact on NOPSI, to a level that, based on substantial evidence, NOPSI could "sustain" (*i.e.*, continue in its business solvent, pay its Grand Gulf bills, and return to financial health). This indicated a disallowance of $150,000,000 — which the Council then reduced to $135,000,000 to provide a safety "buffer." The economic testimony, which was complicated, was

virtually the same as advanced to decide the "irreparable harm" issue; but NOPSI did not assert either that any of the Council's financial findings were arbitrary or that NOPSI was barred from relief in state courts.

NOPSI specifically complains that the district court did not hold an evidentiary hearing; but it omits to state that both NOPSI and the Council had filed extensive affidavits, depositions and briefs on the issue of irreparable harm; that a hearing was originally set; and that the court and counsel held a conference call in which it was decided that the record would be opened for the submission of additional depositions and other materials and the motions would be considered on that record. (R.9.) NOPSI did not object to this procedure or raise the matter on appeal. The district court's opinion recites that it considered all the affidavits presented and noted that NOPSI had also filed suit in Louisiana state court. The court clearly found no need here to provide emergency relief under the "extraordinary circumstance" rule.

As additional background, in *NOPSI I* the district court had held an evidentiary hearing on NOPSI's need for preliminary relief. NOPSI made specific claims about its imminent insolvency; access to financing being imperiled; and other dire events. The court found NOPSI's position not credible, denied an injunction, and held instead that the Council was using every means to keep NOPSI in a positive cash position. (*NOPSI I*, slip op. at 11-12.) As it turned out, NOPSI's predictions proved untrue; those of the Council's witnesses were validated. (R.7, Cecil Aff., p. 29.) Similar claims were presented here, and all of NOPSI's claims were contradicted by expert financial affidavits. While NOPSI's brief does not dwell on its claims, the government brief shows an inexplicable and uncritical solicitude for financial assertions that on their face simply do not constitute irreparable harm, much less extraordinary circumstances.[48]

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[48] The government apparently endorses NOPSI's recitals that the disallowance would "reduce its common equity" (any monetary penalty reduces a corporation's equity); eliminate its retained earnings (a balance sheet entry that is transitional and refills as new earnings are realized); render it unable to sell rate recovery bonds (a claim that was speculative in its own right, and did not preclude other financing options); and jeopardize its ability to continue to pay its FERC-mandated costs (clearly falling short of saying that it could not pay such costs); and make it unable

NOPSI, unlike an ordinary business, has a monopoly providing an essential service to a captive market and receives a steady stream of income at fixed rates. Here the Council's limited disallowance of $135,000,000 was a book deduction against accrued deferrals, representing the value of the entire projected disallowance over a number of years; but the impact was *gradual*, because it was to be implemented by providing a rate *increase* for NOPSI of 4.5% (or $16.6 million annually), rather than the 6% (or $22.1 million annually) that had been set by the parties' settlement, amortized monthly, beginning in April 1988. (JA-211.) Without more, the idea that NOPSI would suffer irreparable harm by the temporary withholding of $375,000 to $500,000 monthly, against allowed annual revenues of more than $325 million, while seeking preliminary relief in state courts, is so implausible as to merit no consideration.

E. Petitioner's Assertion that the Rate Order Interferes with Interstate Commerce Does Not Affect the Need for Abstention

NOPSI's claim (Pet. Br. at 2) that the Rate Order interferes with interstate commerce has no substance. The complaint limits this claim to the allegation that it was improper for the Rate Order to conclude that NOPSI's initial open-ended commitment to Grand Gulf was inappropriate (R.1, Complaint ¶ 38); but the Council based *no* relief on this finding. (JA-23-24.) Nothing in the complaint or in supporting affidavits states that the Rate Order has caused, or will cause, any of NOPSI's Grand Gulf costs to be shifted to the ratepayers elsewhere. To the contrary, there was testimony by NOPSI's President that the absorption of costs by individual companies in the Middle South system did *not* result in a shifting of costs to ratepayers elsewhere. (JA-54.) Moreover, the fact that each operating company on the Middle South system reached a separate rate settlement with its local regulator shows that no uniformity at the retail level jurisdiction was necessary. (*See* n. 24 *supra*.)

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to pay dividends on either preferred or common stock for at least five years (not indicating why this was irreparable either). NOPSI has met all of its Grand Gulf I obligations and recently paid a preferred dividend since the district court proceedings, according to public filings.

II. THERE IS NO PREEMPTION HERE, FACIAL OR OTHERWISE, THAT ELIMINATED THE STATE'S INTERESTS OR DEFEATED ABSTENTION

A. The Legislative History of the FPA and Other Statutes Shows Clear Intent To Prevent Encroachment Upon the States

Petitioner bases its preemption argument principally upon a misportrayal of the Federal Power Act's ("FPA") purpose — *viz*, that Congress believed interstate commerce would be "threatened" unless a "neutral forum" were established to allocate "interstate power pool costs" among the states and "between ratepayers and utility shareholders." (Pet. Br. at 2.) Nothing in the legislative history evinces any such concern. To the contrary, Congress voiced no criticism of state regulation but rather was concerned to protect it.

Before enactment of the FPA, states regulated the retail rates and practices of *intra*state utilities, but there was no federal agency to regulate interstate matters. Because the states were constrained by the Commerce Clause, there was a regulatory gap, bounded by the "bright line" drawn by this Court in the *Attleboro* case.[49] The FPA filled that gap by establishing the Federal Power Commission without detracting from the power of the states. In *Federal Power Comm'n v. Southern Cal. Edison Co.*, 376 U.S. 205, 211 (1964), the Court observed that Congress "apportioned regulatory power between states and federal governments according to [the *Attleboro* test] this Court has developed."

Thus, Section 201 of the Federal Power Act, 16 U.S.C. § 824 (1982), concludes with the specific limitation that federal regulation was "to extend only to those matters not subject to regulation by the States," and denies FERC jurisdiction "over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce." 16 U.S.C. § 824(b)(1).

The legislative history is explicit on this point. The House Report on S. 2796, ultimately passed, stated that:

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[49] *Public Util. Comm'n v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927).

> [T]he Commission is given no jurisdiction over local rates even where the electric energy moves in interstate commerce. . . . The bill takes no authority from State commissions . . . .

H.R. Rep. No. 1318, 74th Cong., 1st Sess. 8 (1935); *see also id.* at 26-27. The Senate Report reflects that a predecessor bill failed in part because it impinged upon the states:

> The revision has also *removed every encroachment upon the authority of the States*. The revised bill would impose Federal regulation *only over those matters which cannot effectively be controlled by the States*. The limitation on the Federal Power Commission's jurisdiction in this regard has been inserted in each section in an *effort to prevent the expansion of Federal authority over State matters*.

S. Rep. No. 621, 74th Cong., 1st Sess. 18 (1935) (emphasis added).

Moreover, contemporaneous legislation, the Public Utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. §§ 79 *et seq.* (1982), indicates that Congress meant to insure that individual companies that were part of *multistate* holding companies were made *more* sensitive to local regulation.[50]

The history of the FPA and PUHCA has clear implications for the abstention question. *See Colorado River Water Conservation Dist.*, 424 U.S. at 814-15. As the Fifth Circuit stated in *NOPSI I*:

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[50] PUHCA, enacted along with the FPA, had as a key purpose *increasing* holding company responsibility to local interests and regulation.

> [T]he purpose . . . is simply to provide . . . effective Federal *and* State regulation . . . .
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> * * *
>
> An operating system whose management is confined in its interest, its energies, and its profits to the needs, the problems, and the service of *one regional community* is likely to serve that community better, to confine itself to the operating business, *to be amenable to local regulation* . . . and responsible to the fair demands of the public . . . .

S. Rep. No. 621, 74th Cong., 1st Sess. 11-12 (1935) (emphasis added). The entire tenor of the Congress was one of respect for and enhancement of state utility regulation.

> The existence of this 'bright line' colors the way we view a preemption claim involving the Federal Power Act . . . . [F]ederal court intervention here may constitute a disruption of a *state* regulatory scheme, for *retail* rate making is clearly a field left to the jurisdiction of the states.
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> * * *
>
> The structure of the Federal Power Act, preserving as it does state jurisdiction over retail rates, suggests that these local institutions should normally proceed unfettered by federal interference.

798 F.2d at 860-61.

Moreover, other statutes — the Anti-Injunction Act, 28 U.S.C. § 2283 (1982), and the Johnson Act, 28 U.S.C. § 1342 (1982) — evince unmistakable Congressional intent that these matters be channelled through the state courts. The *Younger* opinion, noting Congress' manifest "desire to permit state courts to try state cases free from interference by federal courts," 401 U.S. at 43, cited the Anti-Injunction Act as exemplary. That Act prohibits federal courts from enjoining state court proceedings with few exceptions. Although the instant lawsuit seeks to enjoin a regulatory order, rather than a court proceeding to enforce the order, the underlying Congressional policy is similar, as evidenced by *Younger's* reliance on it.

In *Amalgamated Clothing Workers v. Richman Brothers Co.*, 348 U.S. 511 (1959), the Court dismissed the argument that the Anti-Injunction Act should not apply where the state court was said to be "wholly without jurisdiction" because it was preempted by federal law. *Id.* at 515. The Court encountered the argument, *inter alia*, that "unless the federal court can intervene," delay would both undercut federal policy and harm plaintiff. *Id.* at 518. In response, the Court noted that Congress had "in the main relied on the adequacy of the state judicial systems to enforce federal rights, subject to review by this Court," *id.*, and it presented an explicit description of the multiple consumptions of judicial time that result when a dual litigation track is opened, *id.* at 519, precisely as experienced here.

The Johnson Act — which bars district court injunction of any state "order affecting rates chargeable by a public utility" when four statutory conditions are met — is an absolute bar to district court relief. Although it has been given limited application by the lower courts, they often reach the same result on abstention grounds.[51] It was enacted, against a history of utilities' use of the lower federal courts to challenge state orders, to "limit the authority of the public utility corporation to delay, hinder, and impede the states in their regulatory actions." 78 Cong. Rec. 8335 (1934) (testimony of Sen. Hiram W. Johnson, sponsor of the Act). The accompanying legislative report explained the path that should be followed by a utility:

> [A public utility] will be required, in all cases where a State has set up a public-utility commission, to proceed before that commission if it has any complaint. It can appeal from this State board to the State courts; and if it is dissatisfied with the final judgment of the supreme court of the State, it can take an appeal to the Supreme Court of the United States. This is no injustice to the utility company. It is fair to all parties concerned. It would save time and a large amount of money.

78 Cong. Rec. 2038 (1934) (Report of the Senate Judiciary Committee).

B. Established Preemption Analysis Shows the Absence of Any Direct or Facial Claim of Preemption

State jurisdiction is preempted (a) when Congress has expressed a clear intent to preempt state law, *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977), or (b) when it is otherwise clear that Congress has intended to "occupy the field" and leave no room for state law. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Otherwise, state action is preempted only to the extent that it (c) *actually* conflicts with federal law, *Florida Lime & Avocado*

[51] Both the Fifth Circuit and the Fourth Circuit have held that the first statutory condition, requiring that "jurisdiction is based solely on . . . repugnance of the order to the federal constitution" is *not* satisfied where the Supremacy Clause is the basis and therefore reference to a federal law is also involved. Both abstained instead. *NOPSI I*; *Aluminum Co. of Am.*, 713 F.2d at 1028. While respondent disagrees with that statutory interpretation, the point is not argued here.

Growers, Inc. v. Paul, 373 U.S. 132, 142-143 (1963), or (d) "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941); *see Northwest Cent. Pipeline Corp. v. State Corp. Comm'n*, No. 86-1856, slip op. at 13-14 (U.S. Mar. 6, 1989).

Since it is clear here that Congress did not intend to preempt state regulation, but to preserve it; and did not intend to occupy the field, but to prevent encroachment upon state law, it would be necessary to conduct a plenary "conflict-pre-emption analysis." This analysis:

> must be applied *sensitively* in this area, so as to *prevent* the diminution of the role Congress reserved to the States while at the same preserving the federal role.

Northwest Central Pipeline Corp., slip op. at 20 (emphasis added). So stated, this clearly is a matter best left to state court development, and the federal courts should abstain without further detailed substantive analysis.

However, even proceeding further, there is no doubt about the result. The Council's order sets only retail rates. It accepts as a "given" the FERC-imposed cost share. It imposed a disallowance only on the basis of management's failure to realize cost-savings through other transactions. It does not stand as an obstacle to FERC's allocation of Grand Gulf costs, but rather assumes that NOPSI is obligated to pay these costs; and it moderates its remedy so as to avoid even indirect financial effects. No costs are passed to ratepayers in other states. Rather, the order requires the shareholders of the company to accept partial responsibility for imprudent management. Clearly, there is no federal purpose to insulate utility investors from the risks of bad management at the retail level.

The latter point underscores the interest that was involved in identifying utility conduct here, as viewed at the regulatory level, that was deemed intolerable. The Council found a course of managemental indifference to the ratepayers with respect to the company's Grand Gulf commitment. While the Rate Order's extensive evidence and findings cannot possibly be detailed here, summaries are set forth at JA-51 and JA-130.

The Council also found that the economics of Grand Gulf I had become problematical during the 1979-80 period; and that NOPSI, facing a large commitment, should have taken steps to diversify by seeking off-system sales,[52] replacing power, if needed, with alternative coal-fired power. Notwithstanding that the possibility of power sales clearly was on NOPSI's management's mind, NOPSI did nothing. If anything, it sought to deceive the public as to a deteriorating situation at Grand Gulf. (JA-101-102.)

While petitioner attempts to deride the Council's substantive findings, it is instructive to compare the vastly different, contemporaneous behavior of another utility, Public Service of New Mexico ("PSNM"), with respect to its participation in the Palo Verde nuclear plant, as to which the company stated that during 1979:

> [I]t took several steps to manage the effects on its generating capacity of external events . . . [including] a series of strategies to deal with the growing surplus of generating capacity, attempts to reduce PSNM's share of Palo Verde by selling ownership, [and] selling portions of the coal-fired San Juan plant. . . .[53]

— with the behavior of NOPSI's management's behavior here. (JA-122-129.)

The parties' substantive positions tell a tale of two cities. NOPSI's vision is that it could sit on its hands; except, perhaps, to keep the regulator uninformed, and could dissemble regarding the true state of affairs at Grand Gulf. (JA-24; JA-167.) The Council, however, required that NOPSI be accountable to the ratepayers, exercise diligence with respect to power commitments, and manage its risks through available alternatives. Had NOPSI done so, it would not have undercut *any* obligation established by the system or FERC respecting Grand Gulf, but would have remained

[52] The Council's findings, well-based in the evidence, relied on expert testimony; testimony by NOPSI's president and its senior vice president; a history of off-system power sales, particularly AP&L; the fact that the System Agreement had been amended to facilitate such off-system sales; and other factors. (JA-163, JA-166.)

[53] *Electric Utility Week*, Feb. 6, 1989 at 13 (summarizing the utility's sworn testimony in a state public service commission proceeding).

responsible for its share of costs and had offsetting revenues. (JA-165.) The effect would have been to spread the risks — prospective future benefits as well as losses — more widely. But NOPSI did nothing.

Petitioner attacks the substance of the Council's determination by referring to *dicta* of the district court in which the court believed, mistakenly, that the Council's determination rest upon finding a "sucker" to buy Grand Gulf power during the 1979-80 time period. With deference to the district court, this was simply neither the Council's finding nor its necessary basis. The Council had, in fact, addressed this very viewpoint because it had been advanced by a NOPSI witness. (JA-167.)[54]

C. The Decisions of This Court Did Not Preempt the Council's Rate Order

Petitioner's contention that *abstention* is barred by reason of this Court's decisions in the *Nantahala* and the *MP&L* cases, which deal with the substantive issue of *preemption*, is misplaced. Both cases followed *a state court path* to this Court, just as did *Northwest Central Pipeline Corp.*, and they represent a model for review here. Indeed, in *Nantahala* , the Court, instead of expressing criticism of federal abstention there, complimented the state supreme court on "an admirably thorough consideration of the myriad issues before it," 476 U.S. at 961, even though disagreeing with its conclusion.

Regarding preemption, both cases are sharply distinguishable. They involved state attempts to *alter* the FERC's interstate allocation of costs to the local utility for retail purposes; they

[54] Moreover, the district court's statements during the same discussion indicate a misconception of the Council's remedy. The district court believed that the Council had utilized its view that NOPSI should receive a 9% Grand Gulf allocation as its basis for computing the prudence disallowance, but this is inaccurate. An expert witness, whom the Council credited, testified that NOPSI should probably have tried to sell all of its expected share from Grand Gulf but, conservatively, might as a limitation be deemed to have retained 9% of it, which was NOPSI's relative share of system capacity. However, the Council imposed a remedy that was only about one-third the size that this testimony would have merited — *i.e.*, it was effectively as if NOPSI had been required to sell only a 3% portion to offset partially the cost of the 17% portion that had been assigned to it. (*See* JA-210.)

addressed facts where the utility had no choice; and neither case involved the additional evidence present here concerning a failure to pursue other transactions to reduce risks.

In *Nantahala*, the FERC had adopted a formula for the allocation of costs between utilities located in different states, but the state commission adopted an allocation more favorable to its own ratepayers and simply substituted it as a basis for retail rates.[55] This Court held that the "filed rate doctrine" prevented the state from substituting its own formula as a basis for retail rates and required the state to pass through the wholesale costs in order to avoid their "trapping." *Id.* at 970-71. The Court made clear that other retail ratemaking actions, including the recognition of savings, could properly be taken into account, and did not suggest that their offset against the wholesale rate would constitute impermissible "trapping." *Id.* at 968. Importantly, in the penultimate paragraph of the opinion, the Court distinguished the *Pike County* line of cases[56] on the basis of the *choiceless* nature of the utility's situation, noting that, "No source of power besides entitlement and purchased power from TVA is said to be available," *id.* at 973, and that both quantity and price had been fixed by the FERC. *Id.* Here, in contrast, the Council recognized both the price and quantity fixed by the FERC, but focused its attention on available alternatives that NOPSI's management failed to pursue.

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[55] In previous briefs, but not here, NOPSI has adverted to the case of AP&L, which in 1980 was allowed by the other companies to escape its contractual obligations to take Grand Gulf power (to which NOPSI inexplicably agreed). (JA-97.) AP&L's arrangement was achieved at the expense of the other Middle South companies, giving each a larger allocation. In Order No. 234, the FERC allocated a share to AP&L under its formula, notwithstanding the companies' prior agreement. Because the very issue before the FERC was the proper allocation among the companies, the AP&L arrangement, contravening the FERC's allocation, had to be set aside. In contrast, the Council's determination had nothing to do with the intrasystem allocation. It contemplated that NOPSI would accept and remain financially responsible for its share of Grand Gulf, but sell a portion off-system (JA-165), without interference with the FERC's allocation.

[56] *Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n*, 77 Pa. Commw. 28 (1983), among others, holds that because the FERC has approved a rate for power as "reasonable," this does not mean that it is prudent for a utility to accept or buy the power, if there are cheaper alternatives.

Similarly, in *MP&L*, the state supreme court had proposed to undertake a prudence inquiry, (1) in the precise areas reserved exclusively for FERC review (the decision to invest in Grand Gulf, to construct it and to bring it on-line), 108 S. Ct. at 2441; and (2) to override the FERC-ordered allocation to the end that the utility might be deemed "obligated to purchase less Grand Gulf power than" the FERC ordered. *Id.* at 2439. Here, in contrast, (1) the Council disavowed authority to take any action based on either NOPSI's decision to participate in the interstate arrangements for Grand Gulf I or the prudence of constructing or completing it; and (2) it indicated it would not have NOPSI pay any amount for Grand Gulf I other than that ordered by the FERC and assumed that NOPSI was required to make such payments. Critical facts are thus reversed. The Council took as given that NOPSI would be obligated to take and pay for a share of Grand Gulf. It asked instead whether management could properly do nothing in deteriorating economic circumstances and in the face of management's own assertion that it could sell power off-system.[57] The Council reached its decision based on evidence that management should have sold power, but did not do so — factual evidence that has no counterpart in the *MP&L* case. (JA-21, JA-209.)

Moreover, unlike the situation in *MP&L*, the matters underlying the Rate Order could not properly have been determined by the FERC because they raised concerns at an entirely different

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[57] Petitioner contends that the Court in *MP&L* actually ruled on the case here because Council participated there as *amicus*. This mistakes the role of *amici*. *See Sony Corp. v. Universal City Studios*, 464 U.S. 417, 436 n.16 (1984). Moreover, the Council urged only that the Court not rule on the prudence of pursuing offsetting transactions — a concern raised because the Mississippi Supreme Court was not entirely clear about the kind of prudence inquiry it envisioned. However, this Court's opinion was, in fact, clear in specifying that the proposed inquiry in *MP&L* was seen as one to evaluate the decisions to become a party to the Grand Gulf agreements, to construct Grand Gulf and bring it on-line. 108 S.Ct. at 2441. The Council's other position there was that it would be more orderly to obtain a decision of the state commission first because the state court's opinion was imprecise. This Court decided, however, to treat the state court judgment as "final" because the preemption question had "already been answered by the State Supreme Court." 108 S. Ct. at 2438 n. 11. In contrast, the state supreme court has *not* answered any preemption or regulatory question here, and this Court should not, we submit, become involved until it has done so.

level of utility operation. The FERC conducted no inquiry in its Grand Gulf proceeding into what any of the retail utilities could have done in their individual circumstances; but rather it deemed local factors irrelevant to the issue before it of allocating the plant cost among them. 108 S. Ct. at 2441. An inquiry into options available for the individual utilities and the prudent selections of choices among them was not within the FERC's own view of its jurisdiction. The FERC's acting chairman was clear that such an inquiry is "not generally within the scope of issues considered in reviewing the rates and terms for the jurisdictional sale of power." (*See* JA-58.) Indeed, the FERC abjured decision of issues at the retail level and declined, on grounds of deference to state regulation, even to consider "cost equalization" that might have moderated the impact of Grand Gulf costs. *Middle South Serv., Inc.*, 30 FERC ¶ 63,030, at 65,151 (1985).[58]

The issue of NOPSI's failure to seek off-system sales could not have been raised at the FERC (especially for the purpose of setting retail rates and practices). The FERC has power only to approve the rate and terms of an interstate transaction actually filed with it for approval, 16 U.S.C. § 824(e). (Contrast section 7 of the Natural Gas Act, 18 U.S.C. § 171f (1982), granting FERC certification authority.) It exercises this review on the basis of the seller's cost factors. *Monongahela Power Co.*, 39 FERC ¶ 61,350, at 62,095 (1987). Here, when the problem is that a utility *failed* to engage in such a transaction, there is *no* rate to file at the FERC to invoke its jurisdiction — much less to stimulate unprecedented

[58] In a lengthy footnote (Pet. Br. at 12 n.18) NOPSI contends that there is a FERC "methodology" (which NOPSI itself has concocted) by which the FERC would have undone NOPSI's off-system sales of power by attributing the sales to the "system" as a whole. There is utterly no basis for this — and particularly no basis for the unprecedented assumption that once the power costs of Grand Gulf were properly allocated among the companies, the FERC would have any interest in *preventing* the companies from making power resales. The FERC has never so contended. More importantly, NOPSI *never* raised this argument during the prudence hearings nor in any of the federal courts below. Rather, the argument appeared for the *first* time in NOPSI's brief submitted in Louisiana *state* court ("Memorandum in Support of Petition for Review" (Aug. 8, 1988) at p. 8, filed in No. 88-4511, pending in Civil District Court for the Parish of Orleans). It should first be decided there.

FERC inquiry into a retail area. As a result, the utility here would, if no state review were possible, escape regulation entirely.[59]

During the prudence inquiry, NOPSI made quite a different argument — to the effect that the Middle South "system" would use the intercompany agreements somehow to subvert and prevent NOPSI's off-system sales — notwithstanding explicit evidence that the system agreements had been modified to facilitate such sales. NOPSI's position did not survive cross-examination. (JA-164-165.)

Petitioner also argues that the Council's finding "rests on the premise that the allocation was unreasonable" — which, it says, is contrary to FERC's determinations. (Pet. Br. at 12.) Similarly, it argues that the Council's disallowance "ultimately rests upon its findings that the Grand Gulf I power was 'excessively priced or uneconomic for other reasons.'" (Pet. Br. at 10.)[60] NOPSI also contends that since the Court in *MP&L* stated that it cannot be "unreasonable" for MP&L to procure the power FERC has ordered it to pay, then "[o]bviously . . . it cannot be unreasonable to retain it." (Pet. Br. at 36.)

These arguments use words in shifting senses that confuse the reasonableness of the FERC's allocation among the companies with the commercial realities facing NOPSI's management. The Court of Appeals reviewing the FERC order has characterized Grand Gulf as "catastrophically uneconomical." A "reasonable allocation" of a "catastrophically uneconomical" power source does not mean that resulting power costs are

[59] Indeed, the only way that the prudence of not making off-system sales could in theory have been properly raised before the FERC would have been through the complaint of a different and hypothetical wholesale customer of NOPSI (*i.e.*, *not* the one buying the Grand Gulf power from it), whose rate was based at least in part on NOPSI's Grand Gulf costs, arguing that NOPSI's wholesale rate for it was too high, by reason of NOPSI's failure to sell. There was never such a complaint filed by such a hypothetical wholesale customer, and thus no basis on which the FERC could acquire jurisdiction to consider the matter. This situation would, in any event, provide no way for the Council to raise the matter before the FERC.

[60] NOPSI's quotation is drawn not from the facts or determinations made in this case, but from a hypothetical dealing with leasing that was put forward in the Council's Brief in Opposition to the Petition for *Certiorari*. (Pet. Br. at 10, 14.)

economic in any real-world sense, nor that a utility should be freed of responsibilities to moderate their effects if it was possible to do so. If the utility had *no* alternative, management may not be faulted. Thus, the choiceless nature of the situation was essential to both the *MP&L* and *Nantahala* decisions, and no other alternative was proposed. Here, however, it has been determined, as fact, that such a choice existed. If it existed, then, as a matter of utility responsibility, it was imprudent not to take advantage of it. There is no conflict whatever with the Court's rulings.

CONCLUSION

Petitioner's brief is unclear on the relief it requests, but the government asks that this matter be remanded to the district court for full consideration of the preemption claim on the merits. (Gov't Br. at 13.) Respondent agrees that there should be full consideration of the merits, but in Louisiana state courts, where they have been argued. The government and NOPSI should not be pressing a point lost many cases ago, that the lower federal courts should be viewed as protectors of federal law and the state courts as the enemy. The decision below to abstain should be affirmed.

Respectfully submitted,

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Respondents.

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PETITIONER'S REPLY BRIEF[1]

The briefs of respondents and their *amici* confirm that the Fifth Circuit's ruling is a departure from settled abstention principles. They concede that the decisions of this Court (and the nearly uniform decisions of courts of appeals) have upheld federal equitable relief against state utility proceedings or orders preempted by federal statutes and rejected claims that federal claimants should be remitted to state judicial or administrative remedies in such cases.[2] And respondents concede that a federal court's responsibility in cases raising such threshold preemption claims is to "undertake a very limited assessment of the alleged federal [preemption] bar to determin whether it is 'direct' or 'facial' and dispositive" and to abstain only if the court concludes it is not. Resp. Br. 30; *see id.* 25. In that circumstance, the issue cannot be held to be "predominantly local" under *Burford* and the proceed-

[1]The Statement Required By Rule 28.1 appears at page ii of the Petition For Certiorari.

[2]*Compare* Respondents' Brief ("Resp. Br.") 25-28 and Amicus Brief of National League of Cities, *et al.* ("NLC Br.") 25-26, *with* Petitioner's Brief ("Pet. Br.") 24-26.

ing cannot be found to further "legitimate state interests" under *Younger*, without implicitly rejecting the federal preemption claim on the merits. *See Knudsen Corp.* v. *Nevada State Dairy Commission*, 676 F.2d 374, 377 (9th Cir. 1982).

The complete answer to respondents and their *amici* is that the Fifth Circuit did *not* apply the standard that respondents concede to be required by settled law (and that petitioner and the Solicitor General urge).[3] The Fifth Circuit did not make a "preliminary assessment" that NOPSI's preemption claim was not "facial, direct, or 'readily apparent' and, of course, dispositive." Resp. Br. 25. To the contrary, the Fifth Circuit not only assumed that a valid such preemption claim was presented (Cert. App. 11A), but also stated that the "language of [*MP&L*] seems to foreclose" the Council's inquiry into "NOPSI's asserted imprudence in failing to resell the [Grand Gulf 1] power." Cert. App. 13A.

In short, the application of respondent's own test requires that the Fifth Circuit's abstention judgment be reversed and the case be remanded for decision of the merits of the preemption claim.

Nevertheless, respondents and their *amici* seek to defend the Fifth Circuit's judgment. Their arguments ultimately rest on two principal grounds. First, they urge a radical expansion of the scope of abstention in which a state's "adjudicatory" interest in "setting its own house in order" would be sufficient under *Younger* to require that all federal challenges to municipal or state administrative actions be channelled through state courts. This is nothing less than a proposal that this Court overrule decades of § 1983 and other decisions and destroy the federal district court's role in the vindication of federal rights against state action. Second, respondents make a series of irrelevant and erroneous arguments regarding the merits of NOPSI's preemption claim.[4]

[3]There is no material difference between respondents' standard and the Solicitor General's standard that the federal court determine whether the federal preemption claim is "substantial and would be dispositive of the merits of the lawsuit." SG Br. 23.

[4]In this regard, Respondents' Brief is pervaded with erroneous and inflammatory "factual" assertions. NOPSI will not respond to these because they are irrelevant to the abstention issue.

I. The Fifth Circuit's Preemption Decision Cannot Be Upheld Unless The Court Holds That The State's "Adjudicatory" Interest Overrides A Federal Claimant's Right To Litigate Federal Claims In Federal Courts.

Respondents and NLC each contend that NOPSI's abstention argument must rest on a premise that Louisiana state courts are biased or incapable of deciding federal preemption claims quickly and correctly. *See* Resp. Br. 23; NLC Br. 19 n.12. This is simply false. Neither NOPSI nor the United States has made such a claim. The basis for our contentions, rather, is that Congress gave federal claimants a right to challenge state action in federal district courts for compelling reasons and that neither *Younger* nor *Burford* provides any basis for denying NOPSI's right to choose a federal forum to raise its federal preemption claim.

Indeed, Respondents' Brief demonstrates that the availability of a federal forum has critically important consequences for the implementation of statutes like the Federal Power Act and the protection of federal rights.[5] The fact is that NOPSI and two other MSU operating companies could not obtain the rate relief (to which they were later held to be entitled in *MP&L*) until *after* federal district courts agreed to hear the federal preemption and Commerce Clause claims.[6]

[5]Respondents state that they agreed to the March, 1986 rate settlement that recognized NOPSI's FERC-mandated Grand Gulf 1 expenses only after the initial Fifth Circuit holding in *NOPSI I* that abstention was improper and that "[i]f anyone was 'forced' then to settle by an abstention decision, it was the Council." Resp. Br. 32. This is an admission that, but for the Fifth Circuit's initial decision against abstention, NOPSI might not have obtained any Grand Gulf relief (other than minimal fuel costs savings) to this day and been long ago driven into bankruptcy.

[6]Just as NOPSI obtained no such relief until a federal forum was held to be available, MP&L and AP&L were unable to obtain any Grand Gulf relief from their state commissions until after federal actions were brought and federal courts set hearings on their federal preemption claims. *See Mississippi Power & Light Co.* v. *Mississippi Public Service Comm'n*, No. J85-0792(L) (S.D. Miss.); *Arkansas Power & Light Co.* v. *Arkansas Public Service Comm'n*, No. LR-C-85-571 (E.D. Ark.); *see*

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It is because the availability of a federal forum can have such importance that Congress refused to rely on state courts to vindicate federal rights and constituted the lower federal courts as " 'the *primary* and powerful reliances for vindicating every right given by the Constitution, the laws, and treaties of the United States.' " *Steffel* v. *Thompson*, 415 U.S. 452, 464 (1974) (citations omitted) (emphasis in original). It is for this same reason that this Court has repeatedly held that abstention is an "extraordinarily narrow" exception to the virtually "unflagging obligation" of federal district courts to exercise the federal question jurisdiction conferred by Congress. *Colorado River Water Conservation Dist.* v. *United States*, 424 U.S. 800, 817 (1976). The Fifth Circuit's decision to create such an exception here is contrary to both *Younger* v. *Harris* and *Burford* v. *Sun Oil Co.*, and would severely impair § 1983 litigation and the implementation of important federal statutory schemes.

A. There Is No Basis For Abstention Under *Younger* v. *Harris*.

In defending the Fifth Circuit's abstention decision, respondents and their *amici* now rely almost exclusively on the doctrine of *Younger* v. *Harris*, 401 U.S. 37 (1971).[7] They concede that *Younger* abstention is not proper unless the exercise of federal equity jurisdiction implicates state interests that are determined by the federal court to be "legitimate" and "important." The reason is that, absent such an interest, there is no possibility that allowing the state proceeding to go forward would permit the state to offer a "narrowing construction" or otherwise "mediate" between legitimate state and federal interests. Resp. Br. 19; Pet.

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Arkansas Power & Light Co. v. *Missouri Public Service Comm'n*, 829 F.2d 1444 (8th Cir. 1987). Federal courts had previously held that neither *Younger* nor *Burford* authorized federal court abstention over these federal claims. *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 772 F.2d 404, 417 (8th Cir. 1985).

[7]Although the Fifth Circuit's decision rests primarily on *Burford*, respondents have not made an independent *Burford* argument, but treat *Burford* as a "special case of comity-based abstention" under *Younger*. Resp. Br. 20.

Br. 30 n.32; *Moore* v. *Sims*, 442 U.S. 415, 429-30 (1979).[8] Respondents and *amici* claim that two such legitimate state interests are present here, but neither claim possesses any substance.

1. The State's Generalized Interest In Retail Ratemaking Cannot Justify *Younger* Abstention.

The only substantive interest that respondents and *amici* identify is the state's generalized interest in regulating local utilities and setting retail rates.[9] NLC Br. 9-10; Resp. Br. 21. But that

[8]Contrary to NLC's arguments (NLC Br. 11-12), the *Younger* exception for patently unconstitutional statutes that are incapable of valid application (*Younger*, 401 U.S. at 53-54) proceeds from this same premise. If a state pursues an otherwise "legitimate" interest by instituting a proceeding under an incurably invalid statute, there is no "opportunity for narrowing constructions that might obviate the constitutional problem" and no need to permit the state proceeding to go forward. *Moore* v. *Sims*, 442 U.S. 415, 429-30 (1979).

NOPSI here has argued both (1) that the Council cannot be held to have a "legitimate interest" in the prudence review without deciding the merits of NOPSI's preemption claim (Pet. Br. 32-34) and (2) that the Ordinance instituting the prudence review and the Council's Order are, in any event, "incapable of valid application" because they invade FERC's exclusive jurisdiction (Pet. Br. 35-38). Contrary to NLC's contention, therefore, NOPSI's arguments would not allow federal courts to "pretermit state lawsuits whenever a state agency or trial court made what was purported to be a plain error of federal law." NLC Br. 12.

[9]Respondents and their *amici* recognize that the Council's prudence investigation and ratemaking proceedings are concluded, but they contend that review of a municipal rate order in a state court of general jurisdiction should be deemed a continuation of the earlier utility proceeding for *Younger* purposes. *See, e.g.*, Resp. Br. 31 ("The Council's own ratemaking and prudence inquiry, even though complete, constitutes an 'ongoing proceeding' because it is subject to state judicial review"). In respondents' view, when the state had a "legitimate interest" in instituting a coercive administrative or legislative proceeding, then that same interest bars a federal court challenge after final administrative action is taken and the only question is where "remedial" judicial review proceedings may be instituted.

This contention is unsustainable, and has been repeatedly rejected by this Court. *See* pp. 10-14, *infra*. It would require a radical incursion into the jurisdiction of federal courts—and destroy § 1983 litigation—if the availability of review of final nonjudicial action in state courts could,

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interest is not in issue here. Petitioner has *not* sought to enjoin the City from determining NOPSI's retail rate base and rate of return, establishing NOPSI's non-Grand Gulf operating expenses, determining how Grand Gulf 1 expenses should be phased-in, or "choosing among rate structures." NLC Br. 5. To the contrary, the Council exercised this legitimate authority in its March, 1986 rate ordinance (*see* Pet. Br. 9), and NOPSI has neither challenged any aspect of this rate order nor sought to interfere with the Council's ability to perform any of these legitimate state ratemaking functions in the future. *See* Pet. Br. 27.

Rather, NOPSI's sole claim is that the Council's ratemaking order is preempted in the one limited respect recognized in this Court's decisions in *MP&L* and *Nantahala*: that the Federal Power Act requires the Council to include NOPSI's Grand Gulf 1 expenses in retail rates and prohibits the Council from "undertak[ing] a prudence review for the purpose of deciding whether to enter" "an order 'trapping' the costs [NOPSI] is mandated to pay" by FERC. *MP&L*, 108 S. Ct. at 2439. Indeed, the precise holding of *MP&L* is that when, as there and as here, a retail rate order is entered that includes Grand Gulf 1 expenses, the Federal Power Act preempts the state from instituting a separate proceeding to investigate the prudence of those costs and to "roll back" the rates by "trapping" FERC-mandated costs. *Id*. In short, the Court's holding in *MP&L*—and NOPSI's claim here—is that a state prudence review of Grand Gulf 1 expenses is wholly outside state authority under *Nantahala*, *MP&L*, and the Federal Power Act, and cannot serve a legitimate purpose.[10]

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under *Younger*, close federal courts to federal claimants. However, the issue does not have to be reached in this case because the Council could not be held to have a "legitimate" interest at any stage of the administrative or judicial proceedings: any such "interest" is preempted by the Federal Power Act.

[10]NLC thus misstates the issue in asserting that NOPSI is claiming that the Council committed a mere "error" of federal law in a proceeding that the Council had authority to conduct. NLC Br. 18. NOPSI's claim here is that the prudence investigation was itself a violation of federal rights and that the Council had no authority either to conduct it or enter any coercive order.

That a state cannot defeat federal jurisdiction over such threshold preemption claims by asserting a generalized interest in "utility regulation" or "ratemaking" is established by this Court's many decisions upholding the exercise of federal equity jurisdiction against state utility proceedings and orders preempted by federal statutes.[11] These decisions teach that the focus of the abstention or exhaustion inquiry is on whether any legitimate interest can be served in the *particular* state proceeding on which the argument for abstention is based. Indeed, when such threshold preemption claims are presented, this Court has not abstained under *Younger* without first deciding that the initiation of the particular state proceeding at issue did not itself violate federal rights, but could serve legitimate state interests. *Ohio Civil Rights Comm'n* v. *Dayton Christian Schools, Inc.*, 477 U.S. 619, 628 (1986); *see* P. Bator, D. Meltzer, P. Mishkin & D. Shapiro, *Hart and Wechsler's The Federal Courts and the Federal System* 1435 (3d Ed. 1988) (*Dayton* decided First Amendment challenge to state administrative jurisdiction "on the merits").[12] Otherwise, a

[11]*See, e.g., Public Utilities Comm'n of Ohio* v. *United Fuel Gas Co.*, 317 U.S. 456 (1943); *Public Utilities Comm'n of California* v. *United States*, 355 U.S. 534 (1958); *City of Chicago* v. *Atchison, T. & S.F. Ry. Co.*, 357 U.S. 77 (1958).

[12]Respondents and their *amici* do not dispute that *Dayton* rejected the constitutional challenge to the state equal employment commission's investigatory jurisdiction on the merits, and that this aspect of the decision was necessary to its holding that the administrative proceeding promoted important and legitimate state interests. However, respondents (Br. 30) and NLC (Br. 16) rely on the fact that *Dayton* and other decisions reject "the argument that a constitutional attack on state procedures themselves '*automatically* vitiates the adequacy of those procedures for purposes of the *Younger-Huffman* line of cases.' " *Dayton*, 477 U.S. at 628 (*quoting Moore* v. *Sims*, 442 U.S. at 427 n.10) (emphasis added); *see Trainor* v. *Hernandez*, 431 U.S. 434 (1977); *Juidice* v. *Vail*, 430 U.S. 327 (1977).

This misses the point. Petitioner does not claim that attacks on state procedures "*automatically*" eliminate any *Younger* bar. In any such case, the Court must address and decide whether the challenged state procedures can serve legitimate state interests and whether allowing the state proceeding to go forward thus permits "mediation" between

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decision to abstain is an implicit decision rejecting the preemption claim on the merits. *See Knudsen Corp.* v. *Nevada State Dairy Comm'n,* 676 F.2d 374, 377 (9th Cir. 1982).

Amicus National League of Cities makes the incongruous argument that a decision to abstain is not an implicit rejection of a threshold preemption claim, but that a federal court will somehow be implicitly deciding that state regulation is preempted if it refuses to abstain. NLC Br. 18. This is simply incorrect.[13] Federal courts of appeals almost uniformly hold that "abstention or exhaustion" is improper when a "challenge to a state regulatory scheme asserts that the proceeding or regulation at issue is beyond the state's authority." *Southwestern Bell Telephone Co.* v. *Arkansas Public Service Comm'n,* 824 F.2d 672, 673 (8th Cir. 1987). Yet these courts often reject the preemption claim on the merits after refusing to abstain. *See id.* at 674-76 (rejecting National Labor Relations Act preemption claim); *Kentucky W. Va. Gas Co.* v. *Pennsylvania Public Utility Comm'n,* 837 F.2d 600 (3d Cir. 1988) (rejecting Natural Gas Act preemption claim on merits after previously holding abstention improper).

As the Solicitor General demonstrates, the inapplicability of *Younger* to challenges to the jurisdiction of state agencies is especially clear when the preemption claim arises under statutes like the Federal Power Act. Congress created FERC to determine the

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legitimate state and federal interests. When there is a threshold challenge to the state's "jurisdiction" to invoke the procedures (as there was not in *Trainor, Juidice,* or *Moore,* but as there is here), this requires a decision of that question.

[13]As NLC's arguments confirm, there is only one rule that would avoid the outcome that a decision on abstention implicitly decides the merits of the case: a holding that *Younger* abstention is required whenever "the federal claim may be presented to a competent state court." NLC Br. 18. NLC's argument thus underscores that the Fifth Circuit's judgment cannot be affirmed unless the Court repudiates four decades of prior decisions and holds that a state's "adjudicatory" interest in keeping "its own house in order" is sufficient to prevent federal claimants from litigating purely federal challenges to state action in federal courts. *See* pp. 10-14, *infra.*

"prudence" and proper allocation of interstate power pool costs because it determined, as had this Court before it, that the interests of states in these questions are inherently in conflict with one another; "uncontrolled regulation by the states" would mean that each individual state would seek to advance its respective local interests at the expense of its neighbors and "patently interfere with broader national interests."[14] State efforts to achieve these parochial objectives have, in recent years, ranged from attempts to order utilities to change their FERC schedules,[15] to direct attempts to use state retail ratemaking to shift costs to other states,[16] to orders (like that at issue here) that purport to affect only a single local utility, but that have consequences for an integrated multistate system, and each state served by it.[17]

As the Solicitor General demonstrates, *Younger* requires a balancing in which "both federal and state interests have to be taken into account" (*Trainor* v. *Hernandez,* 431 U.S. 434, 448 (1971) (Blackmun, J., concurring)), and that balance overwhelmingly favors federal court jurisdiction in preemption cases under statutes like the Federal Power Act. *See* SG Br. 20-23.

[14]*Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n,* 461 U.S. 375, 377 (1983); *see FPC* v. *Southern California Edison Co.,* 376 U.S. 205 (1964); *Public Utils. Comm'n* v. *Attleboro Steam & Electric Co.,* 273 U.S. 83 (1927). Because states would have unavoidable incentives to advance "their respective local interests" at the expense of their neighbors, this Court held in *Attleboro* that state regulation of interstate wholesale electric transaction is a *per se* violation of the Commerce Clause. 273 U.S. at 89-90. In the Federal Power Act, Congress declined to overrule *Attleboro* legislatively—as it could have, *Clark Distilling Co.* v. *Western Maryland Ry. Co.,* 242 U.S. 311 (1917)—and, instead, codified *Attleboro's* "bright line" test.

[15]*Massachusetts Department of Public Utilities* v. *United States,* 729 F.2d 886 (1st Cir. 1984).

[16]*Nantahala Power & Light Co.* v. *Thornburg,* 476 U.S. 953 (1986).

[17]It is no answer that, as in this case, affected states may agree that each should have independent regulatory authority to second guess FERC's allocation order. *See* NLC Br. 20. Indeed, the "common pool" problems that have led each state to prefer its own fora are what prompted Congress to provide for FERC as a neutral adjudicator.

In this regard, NLC is incorrect (Br. 16) that NOPSI and the Solicitor General are contending that abstention is improper in all federal preemption cases.[18] The determination depends on the nature of the preemption claim and its relationship to the pending proceeding. The point is that, here, NOPSI's preemption claim goes to the power of the Council to proceed at all and is dispositive of the entire state proceeding.

2. The State's Adjudicatory Interest In "Keeping Its Own House In Order" Cannot Justify *Younger* Abstention.

Respondents and their *amici* also defend the Fifth Circuit's abstention decision by relying on the "adjudicatory" interest that this Court has repeatedly stated to be insufficient to justify *Younger* abstention. *See* Pet. Br. 29. Specifically, they contend that the state has an interest in confining all federal law challenges to municipal or state administrative actions to state courts so that the state may "'set[ ] its own house in order.'"[19] And respondents and their *amici* contend that this general adjudicatory interest should now be held to be sufficient, under *Younger*, to deny federal claimants their right to pursue federal remedies against unlawful state action in federal district court. This contention has been rejected by a century of decisions of this Court, and respondents and their *amici* are advocating a rule that would destroy § 1983 litigation and end the federal court's historic role as the primary vindicators of federal rights.

Few propositions are better settled in our jurisprudence than that when a final municipal or state administrative action violates federal rights and is causing immediate injuries, injured parties have a right to pursue their claims in federal court, irrespective of whether there are state judicial remedies. That is the law under 42 U.S.C. § 1983. *Monroe* v. *Pape*, 365 U.S. 167, 172-87 (1961);

[18]That broader thesis, however, has been urged in Note, *The Preemption Dimension Of Abstention*, 89 Colum. L. Rev. 310 (1989).

[19]Resp. Br. 22 (relying on "state's interest in developing a system of review competent to vindicate federal rights arising in matters involving its own regulatory bodies") & 25 n.44 (state has "institutional interest in 'setting its own house in order,' through appellate review of its administrative agencies"); *see also* NLC Br. 9, 21-22 & n.16.

see also Patsy v. *Board of Regents*, 457 U.S. 496 (1982) (no requirement of exhaustion of state administrative remedies under § 1983).[20] That is also the rule when state administrative action is challenged in federal equity actions that are not based on § 1983. *Lane* v. *Wilson*, 307 U.S. 268, 274-75 (1939);[21] *City Bank Farmers Trust Co.* v. *Schnader*, 291 U.S. 24 (1934); *Bacon* v. *Rutland R.R. Co.*, 232 U.S. 134 (1914). There is no requirement that state judicial remedies be exhausted before federal challenges to municipal or state administrative or actions may be brought in federal court.

[20]There is no substance to respondents' argument (Resp. Br. 28) that § 1983 cases are inapposite here. First, *Younger* abstention is not only fully applicable to § 1983, but the doctrine has been developed almost exclusively in § 1983 cases. Second, although this case was not brought under § 1983, it is an open question whether it could have been. *See Golden State Transit Corp.* v. *City of Los Angeles*, No. 88-840, *certiorari granted*, 109 S.Ct. 1117 (February 21, 1989). Third, whether or not § 1983 is available, Congress clearly gave the federal district courts jurisdiction to issue "injunctive relief from state regulation, on the ground that such regulation is preempted by a federal statute." *Shaw* v. *Delta Air Lines, Inc.*, 463 U.S. 85, 96 n.14 (1983); *see Golden State Transportation Corp.* v. *City of Los Angeles*, 475 U.S. 608 (1986). That grant of federal jurisdiction altered the relationship between the states and the nation with respect to these claims, in the same way that § 1983 did in cases cognizable under its provisions. *Compare* Resp. Br. 28, *with Zwickler* v. *Koota*, 389 U.S. 241, 245-46 (1967).

[21]*Lane* v. *Wilson* makes it explicit that conventional judicial review proceedings need not be exhausted before state administrative action is challenged in federal court on federal statutory grounds:

> "[T]he plaintiff [here] did not have to pursue whatever remedy may have been open to him in the state courts. Normally, the state legislative process, sometimes exercised through administrative powers conferred on state courts, must be completed before resort to the federal courts can be had. . . . But the state procedure open for one in the plaintiff's situation has all the indicia of a conventional judicial proceeding and does not confer upon the Oklahoma courts any of the discretionary or initiatory functions that are characteristic of administrative agencies. . . . Barring only exceptional circumstances, . . . or explicit statutory requirements, . . . resort to a federal court may be had without first exhausting the judicial remedies of state courts."

307 U.S. at 274-75 (citations omitted).

Respondents and NLC argue that their position is supported by *Huffman* v. *Pursue, Ltd.*, 420 U.S. 592 (1975). *See* Resp. Br. 22; NLC Br. 9, 21-22 & n.16. This is simply incorrect. *Huffman* reaffirmed the well-settled rule that state judicial remedies do not have to be exhausted in federal suits challenging administrative or municipal actions. 420 U.S. at 609-10 n.21, *citing Monroe* v. *Pape, supra; City Bank Farmers, supra,* and *Bacon* v. *Rutland R. Co., supra*.[22] *Huffman* held only that (apart from any *res judicata* bar) *Younger* required a federal district court to abstain in a suit seeking to enjoin enforcement of a state *court's* injunction because states have a legitimate substantive interest in enforcement of judgments of their courts.[23] *See also Pennzoil Co.* v. *Texaco, Inc.*, 481 *U.S.* 1 (1987); *Juidice* v. *Vail*, 430 *U.S.* 327 (1977).

Moreover, to overrule *Monroe* and its precursors now would, quite simply, destroy the role of the federal courts as the primary guarantors of federal rights against unlawful state action. If the state's interest in "setting its own house in order" were sufficient to invoke *Younger*, there would be literally no challenge to nonjudicial state action—under § 1983 or otherwise—that could

[22]The point was reiterated in *Patsy* v. *Board of Regents*, 457 U.S. 496 (1982), and *Ohio Civil Rights Comm'n* v. *Dayton Christian Schools, Inc.*, 477 U.S. 619 (1986). *Patsy* held that once state action is taken that injures a federal claimant, federal judicial remedies may be pursued, and there is no requirement that even nonjudicial state remedies be exhausted. *Patsy*, 457 U.S. at 516. In *Dayton Christian Schools*, the court distinguished *Patsy* and vacated an injunction against continuation of the state administrative investigation only because the administrative proceedings were "coercive, not remedial," and because the investigation itself did not violate any federal rights. *Dayton Christian Schools*, 477 U.S. at 627-28 n.2.

[23]All concede that the Council's prudence investigation was not itself judicial in character. Ratemaking proceedings are not judicial, but are "essentially a legislative function" (*Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 589 (1945)), and The Council of the City of New Orleans is, under any view, a legislative body. Thus, the argument that *Younger* applies here depends solely on the ground that the order entered in this legislative proceeding is reviewable in state courts of general jurisdiction. *See* Resp. Br. 19; *NOPSI I*, 798 F.2d 858, 864 (5th Cir. 1986); p. 5 n.9, *supra*..

be initially brought in federal district court. Cases as diverse as school desegregation suits and suits challenging ordinances violating First Amendment rights or federal statutes would all be barred under *Younger* because there would, invariably, be a right to obtain judicial review in state courts of general jurisdiction.[24] That would defeat the central purposes of § 1983 and of federal question jurisdiction.[25]

These considerations underscore why the Court has so long emphasized that an adjudicatory interest is insufficient to invoke *Younger*. They also underscore that, as the Solicitor General demonstrates, the state's "interest" in the judicial review proceedings now pending in the state courts would be insufficient to invoke *Younger* even if the Council had had a legitimate interest in undertaking the prudence review.[26] *See also* p. 5 n.9, *supra*.

[24]That there are no available limiting principles is confirmed by the facts of this case. Here, for example, no one claims that Council's prudence investigation and order was itself judicial in character. *See* p. 12, n.23, *supra*. There is no difference in principle between the disallowance order entered in this case and a municipal order conditioning renewal of a taxi franchise on the relinquishment of rights under the National Labor Relations Act (*see Golden State Transit Corp.* v. *Los Angeles*, 475 U.S. 608 (1986)), or the actions of a school board maintaining a segregated school system. *Dayton Board of Education* v. *Brinkman*, 443 U.S. 526 (1979). To hold that a state's interest in "keeping its own house in order" prevents a federal court from adjudicating challenges to such nonjudicial state action would represent a radical incursion into the role of federal courts.

[25]As this Court has stated, the "legislative history [of 1983] makes evident that Congress . . . was concerned that state instrumentalities could not protect [federally created] rights." *Mitchum* v. *Foster*, 407 U.S. 225, 242 (1972).

[26]*See* SG Br. 24-27. As the United States demonstrates, the Council's prudence investigation is now concluded and the question is not whether the prudence investigation should itself be enjoined. Rather, the question now is where NOPSI may bring suit to challenge the Council's coercive order on federal preemption grounds: in federal district court or in state court. The state review proceedings are not enforcement proceedings, but are "remedial." The state's interest in these judicial review proceedings, therefore, is "not appreciably greater than its inter-

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Finally, there is no substance to respondents' arguments that NOPSI's and the Solicitor General's position would require review of Council orders to proceed on "dual" litigation tracks. Resp. Br. 22. The theoretical possibility of dual review proceedings is a consequence of the rule that when Congress has granted concurrent jurisdiction, a plaintiff is free to bring suit in both state and federal forums for the same cause of action. *See Colorado River Water Conservation Dist.* v. *United States*, 424 U.S. 800, 809 (1976). Here, however, as the Fifth Circuit found (Cert. App. 10A), the only reason NOPSI filed a petition for review in state court was the uncertainty over the availability of a federal forum. Such protective filings can create no *Younger* or other concerns. *See Kentucky W. Va. Gas Co.* v. *Pennsylvania Public Utilities Comm'n*, 791 F.2d 1111, 1117 (3d Cir. 1986).[27]

B. There Are No Grounds For *Burford* Abstention.

Respondents and their *amici* also argue that *Burford* v. *Sun Oil Co.*, 319 U.S. 315 (1943), and *Alabama Public Service Comm'n* v. *Southern Ry. Co.*, 341 U.S. 341 (1951), establish a general rule

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est in any private lawsuit in which state legislation may be subjected to a challenge on federal constitutional grounds." *Kentucky W. Va. Gas Co.* v. *Pa. Public Util. Comm'n*, 791 F.2d 1111, 1117 (3d Cir. 1986) (citation omitted).

In short, the state has no interest in NOPSI's privately-initiated pending review proceeding that is itself sufficient to justify *Younger* abstention, irrespective of whether Council had a legitimate interest in conducting the prudence investigation. And no one disputes the Solicitor General's showing that no other pending state court proceedings have any pertinence to the abstention inquiry. SG Br. 25-26 & n.21.

[27]Both NOPSI and the Solicitor General have argued that the District Court should not, in any event, have abstained from deciding NOPSI's request for a preliminary injunction (which was filed well before NOPSI made its protective filing in state court). Contrary to NLC's claim (NLC Br. 28), this contention was not rejected in *Doran* v. *Salem Inn, Inc.*, 422 U.S. 922 (1975). *Doran* did not rule on the question whether preliminary relief is separable from permanent relief for abstention purposes, and the Court's opinion has been criticized for that reason. *See, e.g.*, P. Bator, R. Meltzer, P. Mishkin & D. Shapiro, *Hart and Wechsler's The Federal Courts and the Federal System* 1422-23 (3d Ed. 1988).

that federal courts may not entertain suits challenging an order entered in a state utility proceeding if judicial review is available in a state court. That is incorrect. The basis for *Burford* and *Alabama Public Service Comm'n* was that the utility orders had been challenged solely on federal Due Process[28] or state law grounds and that a federal district court resolution of those claims would have required the Court to examine and reweigh the *same* local factors that the state agency had considered—and that were further subject to *de novo* review in specialized state reviewing courts. Pet. Br. 26 n.28; SG Br. 11 n.10.[29] In this circumstance, federal court review would have inevitably disrupted the state's efforts to establish a coherent regulatory policy in an area in which Congress had left the states with primary regulatory authority.

[28]In arguing that *Alabama Public Service Comm'n* is applicable here, NLC contends, erroneously, that "the authority of the Interstate Commerce Commission under the scheme at issue . . . was strikingly similar to FERC's authority in administering the Federal Power Act." NLC Br. 23 n.18. This is simply wrong. The basis for the decision was that the ICC had taken no action that could have preempted the state order requiring the continuation of service, and the federal claim was based solely on the Due Process Clause of the Fourteenth Amendment. *See* 341 U.S. at 346 n.7 & n.9.

[29]Repondents state that courts of appeals "generally have not deemed" the presence of a specialized court to be a requirement of *Burford* abstention. Resp. Br. 20 n.30. This is incorrect. The majority of courts of appeals treat the presence of a specialized reviewing court as a precondition for *Burford* abstention. *Ada-Cascade Watch Co., Inc.* v. *Cascade Resource Recovery, Inc.*, 720 F.2d 897, 903 (6th Cir. 1983) (For *Burford* to apply, "the state must centralize review in a forum with special competence."); *accord J-R Distributors, Inc.* v. *Eikenberry*, 725 F.2d 482, 488 n.6 (9th Cir. 1984); *Association for Retarded Citizens* v. *Olson*, 713 F.2d 1384, 1390-91 (8th Cir. 1983); *Nasser* v. *City of Homewood*, 671 F.2d 432, 440 (11th Cir. 1982).

By contrast, only one of the three cases discussed by respondents even discusses the point, and it states only that centralized review is "not an *absolute* prerequisite" to *Burford* abstention. *Browning-Ferris, Inc.* v. *Baltimore County*, 774 F.2d 77, 80 (4th Cir. 1985) (emphasis added). Other Fourth Circuit decisions emphasize that the presence of centralized review is a critical factor under *Burford*. *Brandenburg* v. *Seidel*, 859 F.2d 1179, 1190-92 (4th Cir. 1988).

In contrast, even respondents and *amici* concede that this Court has repeatedly upheld the exercise of federal equitable jurisdiction against such utility proceedings or orders when the local body's authority was preempted by a federal statute. *See* p. 1 n.2, *supra* & p. 7 n.11, *supra*. These decisions reject claims that the considerations of comity and federalism underlying *Burford* required exhaustion of state administrative or judicial remedies or otherwise foreclosed federal court challenges.[30]

These cases clearly establish that when a local utility proceeding or order is challenged on the ground that it is preempted in its entirety by a federal statute, adjudication of that claim by a federal court cannot be "disruptive of state efforts to establish a coherent [regulatory] policy" and cannot unduly interfere with a legitimate state activity. *Colorado River*, 424 U.S. at 814.[31] For example, contrary to the numerous misstatements of respondents and their *amici*, a federal court injunction against the enforcement of the Council's order would be based on the ground that the Council has been deprived of any jurisdiction to disallow NOPSI's federally-mandated Grand Gulf 1 expenses and is required to include all those expenses in retail rates. "Local factors" will be irrelevant to the resolution of the preemption claim, and the federal court decision would have no implications for the development of state "prudence" policy in areas where state jurisdiction had not been preempted. To the contrary, the decision would simply rest on the ground that the only entity with jurisdiction to determine the prudence of the Middle South System's Grand Gulf 1 costs is FERC.

[30]Contrary to NLC's suggestion (NLC Br. 26-27), the doctrines of exhaustion of administrative or judicial remedies "simply address[ ] many of the same concerns which the various types of abstention are designed to reach." *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n* , 772 F.2d 404, 418 (8th Cir. 1985); *see Iowa Mutual Ins. Co.* v. *LaPlante*, 480 U.S. 9, 16 n.8 (1987); 4 K. Davis, Administrative Law Treatise § 25.1 at 350 (1983).

[31]These cases also foreclose respondents' argument (Resp. Br. 37-38) that the Johnson Act (28 U.S.C. § 1342) and the Anti-Injunction Act (28 U.S.C. § 2283) "evince unmistakable intent" that such federal preemption challenges to state utility proceedings "be channelled through state courts." The Court also there held that the Johnson Act is inapplicable to preemption challenges brought under federal statutes regulating interstate commerce, like the Federal Power Act. *Public Utilities Comm'n of Ohio* v. *United Fuel Gas Co.*, 317 U.S. 456, 469-70 (1943). And as respondents admit and each decision implicitly holds, a suit to enjoin an agency order is wholly outside the Anti-Injunction Act, which prohibits injunctions only against state *court* proceedings. *See* Resp. Br. 37-38. Respondents thus disclaim any intention to rely on the Johnson Act or the Anti-Injunction Act as a separate ground. Resp. Br. 38 n.59.

II. Respondents' Arguments On The Merits Are Irrelevant To The Abstention Question And Erroneous.

Contrary to the claims of respondents (Br. 18) and their *amici* (NLC Br. 13), NOPSI is not asking the Court to decide the merits of its preemption claim. The sole issue before the Court is whether the Fifth Circuit's abstention holding is erroneous, and NOPSI's opening Brief discussed the merits for the sole purpose of demonstrating that its preemption claim is, to say the least, substantial and that the Council's Order disallowing $135 million in Grand Gulf expenses is invalid on its face under *MP&L*. If the Court agrees that the Fifth Circuit's abstention judgment is erroneous, it should remand the case to the Fifth Circuit for decision of the merits of the preemption claim.

Nonetheless, respondents and NLC devote lengthy sections of their briefs to arguing the merits. Most of these arguments are devoted to rearguing claims that were raised and rejected in *Nantahala* and *MP&L*. *E.g.*, Resp. Br. 8-9 & 35-37. The rest simply ignore *MP&L*'s holding that, under the Federal Power Act, a state "may not bar regulated utilities from passing through to retail customers [these] FERC-mandated wholesale rates" and may not undertake *any* form of prudence investigation that would result in the "'trapping'" of any of these costs. *MP&L*, 108 S. Ct. at 2439; Pet. Br. 38. Yet that is precisely what the Council has done.

Respondents' Brief underscores the invasion of FERC's jurisdiction. As FERC found, NOPSI and other MSU companies are required to "operate[ ] as a single . . . coordinated system." 15 U.S.C. §§ 79b(a)(29), 79k(b); *see MP&L*, 108 S.Ct. at 2431. And

this Court has recognized that FERC implicitly found that the construction and completion of Grand Gulf 1 was a reasonable part of an MSU system plan to diversify fuel sources by acquiring nuclear and coal capacity to supplement its oil and gas-fired capacity. *MP&L*, 108 S.Ct. at 2431. Yet now the Council has disallowed $135 million in NOPSI's Grand Gulf 1 expenses on the ground that it was "imprudent" for NOPSI not to "diversify" risk in a different way: by selling off nuclear capacity and buying more coal capacity.[32] The Council's theory is that FERC can determine that Grand Gulf represented prudent planning for the MSU system as a whole, but that the five different state and local ratemaking bodies can revisit this issue and find, based on "local conditions," that individual MSU operating companies should have second-guessed the system's planning process,[33] anticipated FERC's allocation, and sought to nullify both. That is precisely what *MP&L* forbids. *See* 108 S.Ct. at 2441.

The Council's theory is especially meritless, moreover, because the $135 million disallowance depends on the ground that "prudent" NOPSI management would have made hypothetical wholesale purchases and sales of capacity in 1980 (which are subject to FERC jurisdiction)[34] and that FERC would, in 1985, have decid-

[32]The Council's finding that it was imprudent for NOPSI to fail to sell off Grand Gulf 1 nuclear capacity is simply a thinly veiled determination that the FERC allocated too much Grand Gulf capacity to NOPSI. The Council's determination is directly contrary to this Court's holding in *MP&L* that " . . . if the integrity of FERC regulation is to be preserved, it obviously cannot be unreasonable for MP&L to procure the particular quantity of high-priced Grand Gulf power that FERC has ordered it to pay for." *MP&L*, 108 S.Ct. at 2440.

[33]Under the FERC-approved System Agreements, the decisions of whether and when to acquire new generating capacity must be made by a system-wide committee (including one representative from NOPSI and each other MSU operating company) on the basis of the needs of the MSU system as a whole. *See Middle South Energy, Inc.*, 31 FERC ¶ 61,305 at 61,646 (1985).

[34]Contrary to Respondent's misstatement, no claim is made that "once the power costs of Grand Gulf were properly allocated among the companies, the FERC would have any interest in *preventing* the

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ed that these sales should be permitted to reduce NOPSI's actual Grand Gulf 1 expense to the same 9% figure that FERC found would be unjust, unreasonable, and discriminatory in FERC Opinion 234. In short, the Council's arguments dramatically demonstrate that the $135 million disallowance rests on arguments that could have been presented to FERC in 1985, but were not.[35]

It is for these reasons that the Council, in the end, is forced to defend its prudence disallowance on the ground that it has not attempted "to *alter* the FERC interstate allocation of costs," but has merely set retail rates as if a different allocation had been made. Resp. Br. 41 (emphasis in original). However, that argument was rejected in *Nantahala*, and *MP&L* alike. *See* Pet. Br. 37 n.43. In short, it could not be clearer that NOPSI has presented a substantial preemption claim that is dispositive of all issues raised by the Council's Order.

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companies from making power resales." Resp. Br. 44 n.58 (emphasis in original). First, the hypothetical off-system sales that are the basis for the disallowance occurred five years *before* the power costs were allocated, and FERC would have thus taken any such sales into account in allocating costs among MSU companies (just as it took into account other off-system sales, *see* Pet. Br. 5 n.6). Second, even if NOPSI could sell 8% of Grand Gulf 1 off-system today—as the Council found it could not—the point is only that this would be a wholesale sale subject to FERC's exclusive jurisdiction, and FERC would then decide what effect that would have on NOPSI's Grand Gulf 1 costs: that is, whether it would produce a pro rata reduction in the costs of all MSU companies (such that NOPSI's allocation would be reduced by 1.36%) or a reduction in NOPSI's costs alone. *See* Pet. Br. 12 n.18.

[35]Respondents' assertion (Br. 43-44) that FERC would have then had no jurisdiction to consider the hypothetical 1980 transactions is unsupported and unsupportable. FERC has jurisdiction to consider any and all facts that bear on the whether and to what extent Grand Gulf 1 costs should have been included in MSE's rates and allocated to individual MSU companies.

CONCLUSION

For the reasons stated, the judgment of the United States Court of Appeals for the Fifth Circuit should be reversed and the case should be remanded for decision of the merits of the federal preemption claim.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1988

NEW ORLEANS PUBLIC SERVICE, INC., PETITIONER

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether a federal court should wholly abstain from adjudicating a claim, brought by a public utility against a local regulatory authority, that the authority is violating federal law by refusing to honor terms fixed by the Federal Energy Regulatory Commission for the interstate sale of electric power at wholesale.

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In the Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-348

NEW ORLEANS PUBLIC SERVICE, INC., PETITIONER

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Part II of the Federal Power Act, 16 U.S.C. 824 *et seq.*, gives the Federal Energy Regulatory Commission (FERC) exclusive regulatory authority over the wholesale sale and the transmission of electric energy in interstate commerce. FERC is responsible for ensuring that all public utility rates or charges in connection with the transmission or sale of electric energy in interstate commerce are "just and reasonable" (16 U.S.C. 824d(a)). This case was preceded by FERC's decision requiring the four operating companies of a multi-state public utility system to purchase the capacity of a nuclear power plant owned by the system in proportions found by FERC to be just and reasonable. Because of the government's interest in ensuring the integrity of FERC's allocation of capacity and costs among

those operating companies, the United States and FERC participated as amici curiae in *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988). They appeared in support of the public utility's argument there that FERC's exclusive regulatory authority barred the state from refusing to allow the utility to recover its FERC-allocated costs in its retail rates.

This case also implicates the integrity of FERC's authority. It presents the threshold question whether abstention principles preclude a public utility from seeking preliminary or permanent injunctive relief from a federal district court based on a virtually identical claim of federal preemption. The court of appeals in this case impeded the vindication of important federal energy policy by ruling, incorrectly in our view, that federal court abstention was required. At this Court's invitation, we filed a brief at the jurisdictional stage in which we urged that review be granted.

STATEMENT

1. Like *Mississippi Power & Light Co.* v. *Mississippi*, No. 86-1970 (June 24, 1988), this case arises out of FERC's allocation of the capacity and costs of the Grand Gulf Unit No. 1 nuclear generating plant among four operating electric utility companies that are wholly owned subsidiaries of Middle South Utilities, Inc. (MSU). Petitioner, New Orleans Public Service, Inc. (NOPSI), is one of those four companies.[1] Each of the companies sells and exchanges electricity at wholesale across state lines, to each other as well as to unaffiliated companies. They also sell electricity at retail to local customers in separate

[1] The others are Mississippi Power & Light (MP&L), Louisiana Power & Light (LP&L), and Arkansas Power & Light (AP&L).

service areas located in four states. See *Mississippi Power & Light Co.*, slip op. 1-2.

A fifth MSU subsidiary, Middle South Energy, Inc. (MSE) (now Systems Energy Resources, Inc.), was formed in 1974 to own and finance two nuclear generating plants, Grand Gulf 1 and 2, and to sell power from those plants to the utility operating companies. By the late 1970s, it became evident that Grand Gulf's capacity would not be needed immediately to meet demand, which was lower than predicted in earlier forecasts. MSU continued to build the Grand Gulf units on the assumption that, partly because of the relatively low cost of nuclear fuel, the overall costs of Grand Gulf power per kilowatt hour would be lower than that of alternative energy sources. The investment cost of the plants continued to increase dramatically because of regulatory delay, additional construction requirements, inflation, and increased financing costs. As a result, MSU suspended construction of Grand Gulf 2, and, although the investment cost of both Grand Gulf units had been projected at $1.2 billion, the investment cost of Grand Gulf 1 alone proved to be approximately $3 billion. The wholesale cost of electric power produced by Grand Gulf 1, which went into commercial operation on July 1, 1985, greatly exceeds the cost of power generated by other system facilities. See *Mississippi Power & Light Co.*, slip op. 4 & n.5.

2. Under Part II of the Federal Power Act, 16 U.S.C. 824 *et seq.*, the Federal Energy Regulatory Commission (FERC) has exclusive regulatory authority over the transmission of electric energy in interstate commerce and the wholesale sale of electric energy in interstate commerce. FERC is responsible for ensuring that all public utility rates or charges in connection with the transmission or sale of electric energy in interstate commerce, as well as

all rules, practices, and contracts affecting those rates or charges, are just and reasonable (16 U.S.C. 824(a)).

In June 1985, FERC approved wholesale rates for electric power generated by Grand Gulf 1 and allocated its capacity and energy among the four MSU operating companies. See *Middle South Energy, Inc.*, 31 F.E.R.C. ¶ 61,305 (1985), reh'g denied, 32 F.E.R.C. ¶ 61,425 (1985), aff'd *sub. nom. Mississippi Indus.* v. *FERC*, 808 F.2d 1525 (D.C. Cir.), reh'g granted and vacated in part, 822 F.2d 1103 (D.C. Cir. 1987), cert. denied, No. 86-1380 (Dec. 14, 1987).[2] FERC rejected the New Orleans City Council's contention that NOPSI's share of Grand Gulf 1 costs should be 9 percent (see Pet. App. 30A-31A n.11; Br. in Opp. 4-5 n.4). FERC instead concluded that the operating companies should share in the MSU system's total investment in nuclear capacity "roughly in proportion to each company's share of System demand" (31 F.E.R.C. at 61,655-61,656). FERC ordered the following allocation of Grand Gulf 1 costs: AP&L, 36 percent; LP&L, 14 percent; MP&L, 33 percent; and NOPSI, 17 percent (*ibid.*). MSE has accordingly billed the four operating companies for their FERC-allocated share of Grand Gulf costs since Grand Gulf 1 went into service on July 1, 1985. See *Mississippi Power & Light Co.*, slip op. 5-10.

Each of the four operating companies has, with varying success, sought to recover those costs in its retail rates. In *Mississippi Power & Light Co.*, this Court reversed the Mississippi Supreme Court's refusal to allow MP&L full

[2] The District of Columbia Circuit remanded the case to FERC to consider issues relating to the correctness of its allocation of certain Grand Gulf 1 costs. See 822 F.2d at 1103. On remand, FERC further explained and reaffirmed its prior allocation. See *System Energy Resources, Inc.*, 41 F.E.R.C. ¶ 61,238 (1987), petition for review filed, No. 88-1067 (D.C. Cir.).

recovery of its FERC-allocated share of Grand Gulf costs. The Court held that the Mississippi Public Service Commission (MPSC) was required "to treat MP&L's FERC-mandated payments for Grand Gulf costs as reasonably incurred operating expenses for the purpose of setting retail rates" and therefore could not undertake a "prudence" review in order to decide whether to do so (slip op. 15, 17). The instant case is the third in a series of lawsuits that NOPSI has brought in federal district court against the Council of the City of New Orleans, which regulates NOPSI's retail rates, based on the Council's refusal to allow NOPSI to recover its Grand Gulf costs in those rates.

3. *NOPSI I:* On May 17, 1985, NOPSI applied to the Council for a retail rate increase to reflect the Grand Gulf 1 costs allocated to NOPSI by FERC. On July 17, 1985, the Council announced a public hearing, to be held on July 25, 1985, to consider whether interim rate relief for NOPSI was warranted (Res. R-85-423). The Council stated that the issue of interim rate relief needed to be addressed because "various factors, including questions as to the legality and prudency of the [contracts relating to Grand Gulf 1], the prudency and reasonableness of the said expenses, and lack of information on certain relevant matters, prevent the Council from either denying or granting the requested rate relief at the present time" (*ibid.*).

On August 2, 1985, NOPSI filed a complaint in federal district court seeking declaratory and injunctive relief, and money damages (86-546 Pet. App. 37A). NOPSI asked the court, inter alia, to issue preliminary and permanent injunctions enjoining the Council from denying NOPSI recovery, through its retail rates, of its FERC-allocated share of the expenses of Grand Gulf 1. While that action was pending, the Council on September 5, 1985, denied NOPSI's request for interim rate relief (Res. R-85-5261).

On September 16, 1985, the district court granted the Council's motion to dismiss. *NOPSI* v. *City of New Orleans,* No. 85-3398 (E.D. La.). The court held that dismissal was warranted under the Johnson Act, 28 U.S.C. 1342, and under the principles of *Burford* v. *Sun Oil Co.,* 319 U.S. 315 (1943). *Burford* abstention was appropriate, the court concluded, because NOPSI's retail rates were a matter of local concern requiring local administrative expertise and because the Council's actions would not directly conflict with FERC's order.

While the district court's ruling was pending on appeal, the Council and NOPSI entered into a settlement agreement regarding the treatment of Grand Gulf 1 costs (Res. R-86-112). The agreement set out in detail the amounts by which NOPSI could increase its rate base annually until the costs of Grand Gulf 1 were fully recovered. Pursuant to that agreement, NOPSI also agreed permanently to absorb $51.2 million of the costs (*id.* at 4). Both sides purported to reserve their legal rights, including the Council's right to investigate the issue of prudence (*id.* at 11-12).

The court of appeals initially reversed both aspects of the district court's ruling,[3] but on its own motion for reconsideration subsequently reversed itself on the abstention issue. See *NOPSI* v. *City of New Orleans,* 782 F.2d 1236 (5th Cir. 1986), modified, 798 F.2d 858 (5th Cir. 1986), cert. denied, 481 U.S. 1023 (1987). The court concluded that *Burford* abstention was appropriate because "the regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise" (798 F.2d at 862). The court also held that abstention was appropriate under *Younger* v. *Harris,* 401 U.S. 37 (1971), because there was an ongoing administrative proceeding before the Council: "NOPSI would have a full and fair opportunity to litigate its federal claims" through the state appellate process and there were no exceptional circumstances, such as bad faith or harassment, rendering abstention improper (798 F.2d at 864).

[3] See *NOPSI* v. *City of New Orleans,* 782 F.2d 1236 (5th Cir. 1986). The court concluded that the Johnson Act did not apply because NOPSI's request for injunctive relief rested on a "statutorily-based preemption claim" and therefore did not rest solely on the " 'repugnance of the order to the Federal Constitution,' " within the meaning of the Johnson Act (782 F.2d at 1242, quoting 28 U.S.C. 1342)). The court similarly concluded that *Burford* abstention was inappropriate where, as in this case, "the claim presented is predicated upon federal preemption" (782 F.2d at 1243).

NOPSI II: While *NOPSI I* was pending before the court of appeals, the Council announced on October 10, 1985, that it would conduct an investigation into "all aspects of NOPSI's prudence regarding its decisions to enter into its arrangements to purchase a portion of Grand Gulf 1 for the purpose of determining what portion, if any, of NOPSI's Grand Gulf 1 expense shall be assumed by its shareholders, rather than passed through to its retail ratepayers" (Res. R-85-636; see Pet. App. 5A-6A). On November 11, 1985, NOPSI filed a second lawsuit in federal district court in which it sought to enjoin the Council's prudence investigation. NOPSI subsequently amended its complaint to seek an injunction or declaratory relief only to the extent that the Council proposed taking any action to require NOPSI or its shareholders to absorb all or a portion of its FERC-allocated share of Grand Gulf costs.

The district court dismissed NOPSI's complaint. See *MSE* v. *Council of New Orleans,* No. 85-5273 (E.D. La. Dec. 19, 1986). The court ruled that NOPSI's claims were not ripe because it was not yet certain whether the Council intended to intrude into a regulatory area entrusted to

FERC's exclusive authority. The court ruled, in the alternative, that both *Younger* and *Burford* abstention were appropriate.

On appeal, the court of appeals affirmed the district court's dismissal on ripeness grounds and did not address the abstention issue. See *NOPSI* v. *Council of New Orleans*, 833 F.2d 583 (5th Cir. 1987). The court recognized that the Council's prudence investigation could "certainly be interpreted as directed towards areas now off-limits to state regulators" (*id.* at 586). The court nonetheless concluded that NOPSI's request for injunctive relief was not ripe because the Council's inquiry presented "only a possibility of harm to NOPSI. If such harm occurs, the validity of the New Orleans City Council's action will depend on facts not yet in existence" (*id.* at 588). NOPSI would suffer no irreparable injury, the court said, by awaiting the completion of the Council's prudence inquiry (*ibid.*).

NOPSI III: On February 4, 1988, the Council disallowed $135 million of NOPSI's deferred Grand Gulf costs based on the Council's completed prudence inquiry. The Council accordingly required NOPSI to deduct that amount from its rate base and, in order to reflect the disallowance, reduced the rate increases then planned for NOPSI (Pet. App. 24A). The Council based its order on its finding that NOPSI had acted imprudently in three different ways: (1) "NOPSI's oversight and review of its Grand Gulf obligation was uncritical and severely deficient"; (2) "NOPSI made no effort to reduce its risk exposure in the wake of the Three Mile Island Nuclear incident in 1979-80, which demonstrated the risks of operating a nuclear reactor"; and (3) "NOPSI imprudently failed to reduce the risk of its Grand Gulf commitment by selling a portion of its share of the power off-system, that is, to some other user." *Id.* at 8A. The Council explained,

however, that the amount disallowed did not reflect the full extent of NOPSI's imprudence, because that amount would have caused the utility to become insolvent (*id.* at 9A). The Council had instead disallowed only that amount—minus an additional ten percent "buffer"—that it concluded NOPSI could absorb without becoming insolvent (*ibid.*).

NOPSI then filed this action in federal district court, seeking a declaratory judgment and both preliminary and permanent injunctive relief from the Council's rate order. NOPSI's complaint was based solely on federal grounds: its principal claim was that the order was preempted by federal law, and it contended that this claim fell within the exclusive jurisdiction of the federal courts under the Federal Power Act, 16 U.S.C. 824 *et seq.*[4] NOPSI also argued that it would suffer irreparable harm absent preliminary injunctive relief. The disallowance of $135 million in deferred Grand Gulf costs, NOPSI claimed, would reduce its common equity, eliminate its retained earnings, render it unable to sell rate recovery bonds, jeopardize its ability to continue to pay its FERC-mandated allocation of Grand Gulf costs, and make it unable to pay dividends on either preferred or common stock for at least five years.

On March 10, 1988, the federal district court dismissed NOPSI's complaint (Pet. App. 22A-33A). The court agreed with NOPSI that the Johnson Act does not preclude federal court jurisdiction over the lawsuit (*id.* at 25A-26A), but concluded that federal courts do not have exclusive jurisdiction under the Federal Power Act over NOPSI's federal preemption claim (*id.* at 31A-32A). The court also concluded that both *Burford* and *Younger* abstention were warranted. According to the court,

[4] The complaint also alleged that the Council's actions violated the Commerce Clause and were barred by doctrines of estoppel.

abstention was not precluded because the federal government has "not entirely preempted state regulation of retail sales of electricity" and "there is no facial conflict" between FERC's allocation of Grand Gulf costs and the Council's rate order (*ibid.*).

The court of appeals affirmed (Pet. App. 2A-20A). In examining the appropriateness of *Burford* and *Younger* abstention, the court assumed that it is "now clear" that NOPSI could prove "as it alleges, with some apparent evidentiary support," that the Council's order "is beyond the Council's retail ratemaking authority and violates federal law" because the order "results in 'trapping' [of] FERC allocated costs in violation of federal law" and "was based on factors that the state could not legally consider" (*id.* at 11A). The court of appeals concluded that its earlier "opinion in *NOPSI I* nonetheless requires us to uphold the district court's decision to abstain" (*id.* at 20A).[5]

4. *State Court Proceedings:* Three separate lawsuits were filed in Louisiana state courts following the issuance of the Council's rate order. First, in a suit against NOPSI and others, the Council sought a declaration that its order represented a just and reasonable exercise of its regulatory authority and that NOPSI's failure to comply with the order would be unlawful. See *Boissiere* v. *Cain*, No. 88-2503 (Civ. Dist. Ct. Parish of Orleans, La., filed Feb. 4, 1988). Second, in a suit filed the same day against the City Council, the Alliance for Affordable Energy (a local consumer organization) sought an order directing the Council to disallow NOPSI's recovery of additional Grand Gulf costs. See *Alliance for Affordable Energy, Inc.* v.

[5] Like the district court, the court of appeals rejected NOPSI's argument that the Federal Power Act provides federal courts with exclusive jurisdiction over NOPSI's preemption claim (Pet. App. 11A-15A). That holding is not challenged by NOPSI's petition and therefore is not before the Court.

Council of New Orleans, No. 88-2502 (Civ. Dist. Ct. Parish of Orleans, La., filed Feb. 4, 1988). The City Council named NOPSI as a "defendant in reconvention" in the second lawsuit and NOPSI removed both cases to the federal district court. The two cases later were remanded pursuant to the federal court's decision to abstain. See Pet. App. 27A & n.6.

The third pending state action is NOPSI's own lawsuit against the Council in which it seeks relief from the Council's rate order on several state law and federal constitutional grounds. See *NOPSI* v. *Council of New Orleans*, No. 88-4511 (Civ. Dist. Ct. Parish of Orleans, La., filed Mar. 7, 1988, amended Mar. 17, 1988). NOPSI's complaint asserted that the rate order was unlawful under state law because it abrogated a settlement agreement with NOPSI, because it was not supported by substantial record evidence, and because it was based on an improper legal standard of prudence. NOPSI also argued that the rate order violated both the state and federal constitutions because it denied NOPSI due process and constituted a taking of property without just compensation. NOPSI's state court complaint, however, did not seek relief based on NOPSI's federal court preemption claim. Nor did it seek preliminary injunctive relief. In a letter to the state court that accompanied its state court filing, NOPSI notified the court of the pendency of its federal court lawsuit against the City Council and explained that it was filing with the state court in order to avoid later being barred by the applicable state limitations period. NOPSI also explained that it had not included its federal preemption claim because the federal courts had exclusive jurisdiction over that claim, but that it wished to reserve the right to include that count in its state complaint should the federal court subsequently dismiss NOPSI's federal lawsuit.

Following the federal district court's dismissal of NOPSI's action on abstention grounds, NOPSI amended its state court complaint to include a federal preemption argument and also filed a motion for preliminary injunctive relief based solely on its claim of federal preemption. On May 5, 1988, the state trial court denied NOPSI's motion for preliminary relief and on February 16, 1989, after denying a request for expedited consideration, the state court of appeals upheld the trial court's refusal to award interim relief. See *NOPSI* v. *Council of New Orleans,* No. 88-CA-1369 (4th Cir. La. Ct. App.). The parties to the state trial court proceeding initiated by NOPSI have filed cross-motions (now pending before that court) in support of petitions for review and/or summary judgment on the merits. NOPSI has limited its argument to, first, its threshold federal preemption claim and, second, its contention that the Council's order is unlawful under state law because it rests on an erroneous prudence standard and on clearly erroneous findings of fact.[6] Oral argument on those motions was held on November 30, 1988.

SUMMARY OF ARGUMENT

Neither *Burford* nor *Younger* abstention is appropriate in this case. The utility has made a substantial federal preemption claim that a local regulatory authority has improperly "trapped" costs allocated to it by FERC pursuant to FERC's exclusive regulatory authority over the terms of

[6] NOPSI has expressly disclaimed any intent to press further its claims that the Council has abrogated its settlement agreement with NOPSI, violated NOPSI's right to procedural due process, issued determinations that are not sufficiently articulated and that contravene the council's own procedural rules, and raised contentions barred by the doctrines of collateral and judicial estoppel. See NOPSI Mem. in Supp. of Pet. for Rev. 3 n.1 (filed Aug. 9, 1988).

sale of power among members of an interstate utility system. The independent interest of any single State in such an inherently interstate dispute is not sufficient to override Congress's decision to provide the federal plaintiff the choice of a federal forum for the vindication of important federal policies. The judgment below should therefore be reversed and the case remanded for consideration of petitioner's preemption claim on the merits; at the very least, the district court should be instructed, on remand, to consider whether interim relief is necessary to prevent irreparable harm to federally protected interests.

1. *Burford* abstention is not appropriate because this case, unlike *Burford,* concerns the scope of federal regulatory law and policy. The federal question whether a particular FERC allocation must be honored by a local regulatory authority in a particular context is, moreover, qualitatively different from the type of broad and amorphous due process claims raised in *Burford* and *Alabama Pub. Serv. Comm'n* v. *Southern Ry.,* 341 U.S. 341, 347 (1951), the only case since *Burford* in which this Court has squarely upheld abstention on the basis of that decision. In the present case, unlike those cases, resolution of the federal constitutional issue does not turn on "predominantly local factors" (*Alabama Pub. Serv. Comm'n* v. *Southern Ry.,* 341 U.S. at 349), and any resulting disruption of state law or policy would be a deliberate result of an elaborate and comprehensive congressionally enacted seheme.

2. *Younger* abstention is inappropriate because considerations of comity – the most vital factor underlying the *Younger* doctrine – are without substantial force where, as in this case, the interests of several States are at odds as a result of their participation in a multistate "common pool." Judicial respect for the notion of comity does not require federal court dismissal, and the attendant delay

and financial uncertainty, when the conflicting interests of more than one state are involved. Moreover, none of the three pending state judicial proceedings is owed any special deference under *Younger* because none implicates any "important" or "vital" state interest that would be impaired if the federal proceeding were allowed to go forward. The Council's state court filing is not an enforcement action, but merely a request for a declaration of the lawfulness of its actions; the Alliance for Affordable Energy's state complaint is principally directed against the Council, not NOPSI, and raises issues entirely secondary to NOPSI's preemption claim; and NOPSI's own state court action is largely protective in nature—guarding against the possibility of federal court abstention—and thus should not be deemed to have foreclosed NOPSI's preference for a federal forum.

3. Even if partial abstention were justified, the district court should, at least, have given full consideration to NOPSI's request for preliminary injunctive relief. Such interim relief would not have prevented the state courts from deciding the merits of NOPSI's preemption argument but could have prevented any irreparable injury to NOPSI—and frustration of federal policy—resulting from the Council's ongoing refusal to allow full recovery of NOPSI's FERC-mandated share of Grand Gulf costs.

ARGUMENT

A FEDERAL DISTRICT COURT SHOULD NOT WHOLLY ABSTAIN FROM ADJUDICATING A CLAIM THAT THE FEDERAL POWER ACT COMPELS A LOCAL REGULATORY AUTHORITY TO ALLOW A MEMBER OF AN INTERSTATE UTILITY SYSTEM TO RECOVER, THROUGH ITS RETAIL RATES, WHOLESALE COSTS ALLOCATED TO IT BY THE FEDERAL ENERGY REGULATORY COMMISSION

A cardinal principle of federal jurisdiction is the presumptive availability of a federal forum for litigants

who properly invoke the constitutional and statutory authority of the federal courts. See, *e.g.*, *Cohens* v. *Virginia*, 19 U.S. (6 Wheat.) 264, 404 (1821); *Chicot County* v. *Sherwood*, 148 U.S. 529, 534 (1893). And the principle is one of special importance when the litigant is asking the federal court to vindicate a federal right or to protect a federal interest. The abstention doctrine, which permits a federal court to defer to state proceedings in certain limited situations, is a carefully crafted exception to this fundamental concept. See, *e.g.*, *Hawaii Housing Auth.* v. *Midkiff*, 467 U.S. 229, 236 (1984); *Moses H. Cone Memorial Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 13-16 (1983).

Under the court of appeals' approach, however, abstention could become the rule rather than the exception. *Burford* abstention would be required even where, as in this case, the very premise of the federal complaint is that Congress has decided that paramount national concerns demand preemption of purported local concerns. And *Younger* abstention would be required even in a case, such as this one, where the comity principle underlying *Younger* is rendered inapplicable both by the nature of the federal preemption claim and by the character of the pending state proceedings. Congress's decision to provide NOPSI with the choice of a federal forum should have been respected in this case; the court of appeals' failure to do so has impeded the vindication of important federal policies.

A. *Burford* Abstention Is Not Appropriate

1. The court of appeals erred in concluding that the Council's concern with the "regulation and adjustment of local utility rates," and its "local administrative expertise" (Pet. App. 17A), compel *Burford* abstention in this case.

Burford abstention is required only in cases "involving the possibility of unwarranted disruption of a state administrative process." *England* v. *Louisiana State Bd. of Medical Examiners,* 375 U.S. 411, 415 n.5 (1964); see *Zwickler* v. *Koota,* 389 U.S. 241, 249 n.11 (1967).[7] This possibility exists when there are "difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in the case then at bar," or when the "exercise of federal review of the question in a case and in similar cases would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern." *Colorado River Water Conservation Dist.* v. *United States,* 424 U.S. 800, 814 (1976).

Neither circumstance is present here. Resolution of petitioner's claim of federal statutory preemption requires a determination of the scope of *federal* regulatory law and policy. There is "no underlying issue of state law controlling this ligitation." *McNeese* v. *Board of Education,* 373 U.S. 668, 674 (1963). "Nor is the federal right in any way entangled in a skein of state law that must be untangled before the federal case can proceed." *Ibid.* The federal court need only determine the federal question whether, under the Federal Power Act, the Council's refusal to allow NOPSI to recover its FERC-allocated share of Grand Gulf costs (like the MPSC's similar refusal to allow MP&L to recover its FERC-mandated share of those same costs) improperly interferes with FERC's exclusive regulatory authority.

[7] In *Burford,* the Court held that a federal court Fourteenth Amendment challenge to the validity of an order of the Texas Railroad Commission granting a permit to drill oil wells should have been dismissed in favor of resolution by local administrative and judicial forums.

Nor would a federal court's resolution of such a strictly federal question have "an impermissibly disruptive effect on state policy" (*Colorado River Water Conservation Dist.* v. *United States,* 424 U.S. at 815). Any resulting disruption of state law or policy would be a deliberate result of an elaborate and comprehensive congressionally enacted scheme. Congress determined in the Federal Power Act that the proper allocation of power and costs among members of a multistate public utility holding company should be conclusively resolved by a neutral federal administrative forum (FERC) in accordance with federal law. See *Mississippi Power & Light Co.*, slip op. 16-17. To be sure, the Council retains significant authority concerning retail rates. But that authority and the Council's related expertise do not require abstention where there is a substantial federal preemption claim that the Council has exceeded the bounds of its authority by failing to "treat [FERC] allocations as fair and reasonable when determining retail rates" (*Mississippi Power & Light Co.*, slip op. 16)[8] In these circumstances, the underlying premise of

[8] *Mississippi Power & Light Co.* makes clear that, just as local authority over MP&L's retail rates was limited in that case, the Council here "may not enter an order 'trapping' the costs [NOPSI] is mandated to pay under the FERC order • • • or undertake a 'prudence' review for the purpose of deciding whether to enter such an order" (slip op. 17). The court of appeals concluded that "the language of [*Mississippi Power & Light Co.*] seems to foreclose" the Council's inquiry into "NOPSI's asserted imprudence in failing to resell the power it had agreed to, and is now bound by the FERC order to, buy" (Pet. App. 13A).

Although the district court issued its ruling before *Mississippi Power & Light Co.* was decided, that court similarly found little force in the Council's argument against preemption. As described by the district court (Pet. App. 30A), "the Council faults NOPSI not for buying a 'pig in a poke' but for failing to find a sucker to buy it when the faux-pas became apparent." The court added that it "is not ready to

Burford abstention is missing. Cf. *Zablocki* v. *Redhail*, 434 U.S. 374, 379-380 n.5 (1978) ("there is, of course, no doctrine requiring abstention merely because resolution of a federal question may result in the overturning of a state policy").

Finally, *Burford* abstention is inapplicable because the narrow federal preemption issue raised in this case is qualitatively different from the broad and amorphous federal due process claims raised both in *Burford* and in *Alabama Pub. Serv. Comm'n* v. *Southern Ry.*, 341 U.S. 341, 347 (1951), the only post-*Burford* case in which this Court has squarely upheld abstention on the basis of that decision. In *Alabama Pub. Serv. Comm'n*, a railroad argued that a state commission's refusal to permit discontinuance of two intrastate trains constituted an unconstitutional deprivation of its property, and the Court held that the resolution of that claim turned on such "predominantly local factors" (341 U.S. at 349) as the extent of public need for the service in question. Here, unlike *Alabama Pub. Serv. Comm'n*, a federal court is not being asked to resolve an "essentially local problem" (341 U.S. at 348); it is instead being asked to determine the preemptive scope of a complex federal statute for the purpose of ensuring the integrity of a neutral federal administrative agency's resolution of a multistate dispute. That is a task for which "the federal courts are particularly appropriate bodies"

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assume there are many, if any, such suckers purchasing electricity in the wholesale market today" (*id.* at 30A n.11). The district court also commented on the Council's selection of "a figure of 8% for the prudence disallowance," explaining that "the Council, and in this case, everyone else knows that the 8% figure * * * represents the difference between FERC's 17% allocation and what NOPSI consistently claims as its relative share in the MSU system, i.e., 9%. Thus, the disallowed costs bear no apparent relationship to the savings NOPSI is said to have foregone" (*id.* at 30A-31A n.11).

(*United Mine Workers* v. *Gibbs*, 383 U.S. 715, 729 (1966)).[9] Significantly, in both *Burford* and *Alabama Pub. Serv. Comm'n*, this Court stressed the absence of any comparable federal governmental role. See *Burford*, 319 U.S. at 319 ("The federal government, for the present at least, has chosen to leave the principal regulatory responsibility with the States."); *Alabama Pub. Serv. Comm'n*, 341 U.S. at 345, 346 n.7 (case involves exercise of State's "primary authority over intrastate transportation" and not a matter "over which the Interstate Commerce Commission is given exclusive authority under 49 U.S.C. §§ 1 (18-20)").[10]

B. *Younger* Abstention Is Not Appropriate

This Court has emphatically rejected the "suggest[ion] that 'every pending proceeding between a State and a federal plaintiff justifie[s] abstention unless one of the exceptions to *Younger* applies." *Moore* v. *Sims*, 442 U.S. 415, 423 n.8 (1979). The court of appeals in this litigation,

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[9] See *Chemical Specialties Mfrs. Ass'n, Inc.* v. *Lowery*, 452 F.2d 431, 433 (2d Cir. 1971) (Friendly, J.) ("[A]bstention is peculiarly inappropriate when the federal claim is that the state has been ousted from jurisdiction.").

[10] In addition, unlike *Burford* or *Alabama Pub. Serv. Comm'n*, the state courts reviewing the Council's orders cannot fairly be described as either "working partners with the [Council] creating a regulatory system for the [electric utility] industry" (319 U.S. at 326) or as "an integral part of the regulatory process" (341 U.S. at 348). See Field, *Abstention in Constitutional Cases: The Scope of the Pullman Abstention Doctrine*, 122 U. Pa. L. Rev. 1071, 1156 (1974). There is no state court with special expertise responsible for reviewing the Council's orders in its capacity as regulator of utilities. Section 4-1604 of the Home Rule Charter of the City of New Orleans simply provides for judicial review of Council decisions by a local municipal court of general jurisdiction.

however, has paid little more than lip service to the important limitations on *Younger* imposed by this Court and, as a result, has upheld abstention in a case wholly lacking in the most "vital consideration" prompting *Younger* abstention—concern for interests of "comity" and "federalism" (401 U.S. at 44).[11] See *Ohio Civil Rights Comm'n* v. *Dayton Christian Schools, Inc.*, 477 U.S. 619, 626-627 (1986).

1. As described by this Court, the "notion of 'comity' * * * is the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways." *Younger*, 401 U.S. at 44; see *Middlesex County Ethics Comm'n* v. *Garden State Bar Ass'n*, 457 U.S. 423, 431 (1982). The extent to which comity concerns are implicated by allowing a federal lawsuit to go forward in the face of a parallel state proceeding depends, among other things, on the nature of the federal deprivation alleged.[12] Where, as in this case, the interests of several states are at odds because of their participation in a multistate "common pool," the notion of comity—of allowing each state to perform its separate function—loses much of its force.[13] In such a case, a decision by the tribunals of any

[11] In fact, the court of appeals panel in *NOPSI III* did indicate its awareness of the inappropriateness of *Younger* abstention but clearly felt bound by the panel decision in *NOPSI I*: "The Council's arguments in the successive cases indicate a certain amount of adroitness, but the opinion in *NOPSI I* nonetheless requires us to uphold the district court's decision to abstain" (Pet. App. 20a).

[12] See *Harman* v. *Forssenius*, 380 U.S. 528, 537 (1965) (upholding district court's refusal to abstain under *Railroad Comm'n of Texas* v. *Pullman Co.*, 312 U.S. 496 (1941)).

[13] The common pool may consist of shared benefits, as in *Nantahala Power & Light Co.* v. *Thornburg*, 476 U.S. 953 (1986), or of shared burdens, as in this case and *Mississippi Power & Light Co.*, slip op. 18.

one state in favor of its citizens may have a corresponding direct adverse effect on citizens of other participating states. See *Mississippi Indus.* v. *FERC*, 808 F.2d at 1548-1549; *Appalachian Power Co.* v. *Public Serv. Comm'n*, 812 F.2d 898, 904-905 (4th Cir. 1987); *Middle South Energy, Inc.* v. *Arkansas Pub. Serv. Comm'n*, 772 F.2d 404, 416-417 (8th Cir. 1985), cert. denied, 474 U.S. 1102 (1986); see generally, Hardin, *The Tragedy of the Commons*, 162 Sci. 1243 (1968). Unlike the federal claims at issue in *Younger* and its progeny, therefore, the claims in such inherently interstate disputes are not readily susceptible to resolution by leaving states "free to perform their separate functions in their separate ways." Indeed, it is for that very reason that Congress decided to assign to FERC exclusive authority over such disputes.[14]

We do not, of course, contend that state courts are presumptively incapable of giving neutral consideration to federal preemption claims. "Minimal respect for the state processes * * * precludes any presumption that the state courts will not safeguard federal constitutional rights." *Moore* v. *Sims*, 442 U.S. at 433.[15] Nor do we suggest that abstention is always and necessarily undesirable whenever

[14] Similar concerns underlie this Court's Commerce Clause precedents in which the Court has struck down, even in the absence of conflicting federal legislation, parochial state laws that unduly favor in-state economic interests over interstate commerce. See, *e.g.*, *New Energy Co.* v. *Limbach*, No. 87-654 (May 31, 1988), slip op. 3-4; *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263, 268-269 (1984); *New England Power Co.* v. *New Hampshire*, 455 U.S. 331, 338-339 (1982); *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 35-37 (1980); *Philadelphia* v. *New Jersey*, 437 U.S. 617, 623-624, 627 (1978).

[15] There may, however, be some basis for concern in the circumstances of this case, at least with respect to the underlying administrative order that is challenged in this proceeding. The Council is a popularly elected legislative body. When setting rates, its pro-

a federal plaintiff raises a federal preemption claim. See *Lake Carriers' Ass'n* v. *MacMullan*, 406 U.S. 498, 511-512 (1972) (*Pullman* abstention warranted on claims of federal unconstitutionality and federal statutory preemption). Our view is rather that federal preemption claims, turning as they frequently do on an understanding of a complex federal regulatory scheme, are less likely to present appropriate occasions for deference to state tribunals. See, *e.g.*, *Kentucky West Va. Gas. Co.* v. *Pennsylvania Pub. Util. Comm'n*, 791 F.2d 1111, 1116-1117 (3d Cir. 1986).

Whether abstention is justified in a case involving a claim of federal preemption depends, among other things, on the relative significance of the preemption claim in the lawsuit, on its relation to issues of state law, and on the nature of the preemption argument. In our view, all of

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ceedings are not judicial; they are "essentially a legislative function." *Colorado Interstate Gas Co.* v. *Federal Power Comm'n*, 324 U.S. 581, 589 (1945). The Council has also been considering a municipal takeover of NOPSI as a means of avoiding Grand Gulf costs. See *NOPSI* v. *City of New Orleans*, 800 F.2d 488 (5th Cir. 1986).

Moreover, contrary to this Court's assumption in past cases involving *Younger* abstention, it is now no longer true that "where a final decision of a state court has sustained the validity of a state statute challenged on federal constitutional grounds, an appeal to this Court lies as a matter of right" (*Huffman* v. *Pursue, Ltd.*, 420 U.S. 592, 605 (1975)). Congress recently abolished that aspect of this Court's appellate jurisdiction, effective September 25, 1988. See Act of June 27, 1988, Pub. L. No. 100-352, §§ 1, 7, 102 Stat. 662, 664. In view of this change, it would no longer be possible for NOPSI to attempt to frame its arguments in state court in a manner that, in the words of *Huffman*, 420 U.S. at 605, would have "assured [it] of eventual consideration of its claim by this Court" pursuant to its appellate jurisdiction. Cf. *Mississippi Power & Light Co.*, slip op. 14 n.10 (appeal dismissed because appellant "never challenged the constitutionality" of the relevant state statute but "merely argued" that exercise of state authority would violate the Supremacy Clause; certiorari granted).

these factors render abstention inappropriate in this case. NOPSI's preemption claim is substantial and would be dispositive of the merits of the lawsuit (see note 8, *supra*). There are no unresolved threshold issues of state law that must be decided prior to resolution of that claim; indeed, no state law issues of any kind are raised in this proceeding (compare *Lake Carriers' Ass'n* v. *MacMullan*, 406 U.S. at 511-512; see also *Pennzoil Co.* v. *Texaco Inc.*, 481 U.S. 1, 11-12 & n.9 (1987)). And, as described above, the special nature of NOPSI's preemption argument, dependent as it is on the resolution of multi-state interests, deprives the considerations underlying *Younger*, particularly the notion of comity, of substantial force. For all these reasons, the kinds of concerns that *Younger* abstention has protected in other cases from "needless obstruction" and "undu[e] interfere[nce]" are not present here. See *Pennzoil Co.* v. *Texaco Inc.* 481 U.S. at 10; *Moore* v. *Sims*, 442 U.S. at 429; *Trainor* v. *Hernandez*, 431 U.S. 434, 441 (1977); *Kugler* v. *Helfant*, 421 U.S. 117, 123 (1975).

2. The character of the pending state proceedings also militates against *Younger* abstention. *Younger's* genesis, and still its core concern, lie in the need to prevent undue federal court interference with ongoing state criminal proceedings. While the doctrine's reach has been extended to certain state civil and administrative proceedings, abstention in those cases, unlike this one, was necessary in order to safeguard "important" or "vital" state interests.[16]

There are in this controversy three pending state judicial proceedings: (1) the Council's lawsuit seeking a declara-

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[16] See, *e.g.*, *Pennzoil Co.* v. *Texaco, Inc.*, 481 U.S. at 12-14; *Ohio Civil Rights Comm'n* v. *Dayton Christian Schools, Inc.*, 477 U.S. at 627; *Middlesex County Ethics Comm.* v. *Garden State Bar Ass'n*, 457 U.S. at 434; *Moore* v. *Sims*, 442 U.S. at 423; *Juidice* v. *Vail*, 430 U.S. 327, 335 (1977); *Huffman* v. *Pursue, Ltd.*, 420 U.S. 592, 604 (1975).

tion of the lawfulness of its action; (2) the Alliance for Affordable Energy's lawsuit seeking additional rate relief for consumers;[17] and (3) NOPSI's lawsuit seeking full recovery, through its retail rates, of its FERC-allocated share of Grand Gulf costs. See pages 10-12, *supra*.[18] NOPSI's federal court complaint does not seek, as in *Younger*, *Ohio Civil Rights Comm'n*, *Middlesex County Ethics Comm.*, *Moore*, or *Huffman*, to enjoin any of these ongoing proceedings. Nor does it intend, as in *Pennzoil* or *Juidice*, to interfere with the "regular operation of [a state's] judicial system" by challenging either its "contempt process" or its "ability * * * to enforce orders and judgments of courts."[19] There will be no "eviscerating

[17] Before the district court decided to abstain, the lawsuits filed by the Council and by the Alliance had been removed by NOPSI to federal district court. See Pet. App. 27A & n.6. Hence, perhaps for that independent reason, *Younger* abstention was not required on their account.

[18] Because NOPSI's present lawsuit challenges the results of the completed administrative proceeding, this case, unlike *NOPSI I*, does not directly present the question whether abstention would be appropriate if such an administrative proceeding were pending. We believe abstention would likewise not be warranted in that context, however, both for the reasons described in our brief filed in response to this Court's invitation in No. 86-49, and because the Council's proceedings, unlike the administrative proceedings challenged in *Ohio Civil Rights Comm'n* v. *Dayton Christian Schools, Inc.*, 477 U.S. at 628, themselves violated NOPSI's federally protected rights: they unlawfully "trapped" NOPSI's FERC-mandated Grand Gulf costs pending completion of the Council's prudence investigation (see *Mississippi Power & Light Co.*, slip op. 17 & n.12). See *Public Utilities Comm'n* v. *United Fuel Gas Co.*, 317 U.S. 456, 468-469 (1943).

[19] For this reason, the Council's reliance on *Pennzoil* (Br. in Opp. 3, 23) is misplaced. The federal injunction sought in *Pennzoil* would have interfered with a "vital" state interest—the execution of state court judgments—and "would [have done] so on grounds that challenge the very process by which those judgments were obtained"

impact on state enforcement action" (*Trainor* v. *Hernandez*, 431 U.S. at 446). The sole impact of the federal court's ruling on the pending state proceedings would be its res judicata effect, which is not in itself enough to warrant abstention; otherwise, contrary to this Court's teachings (see page 19, *supra*), *Younger* abstention would be required virtually any time a related state proceeding was pending.[20]

The pending state proceedings do not themselves implicate any "important" or "vital" state interest. The only discernible purpose of the Council's lawsuit is, by filing a "first-strike" action on the very day its order was issued, to attempt to deny NOPSI its choice of a federal forum.[21]

(slip op. 11). No analogous state interest is implicated in this case. Nor is the constitutional issue here—essentially a question of the preemptive effect of a federal statute under the Supremacy Clause—comparable to the Fourteenth Amendment due process claim that the decision in *Pennzoil* sought to avoid.

[20] Of course, the federal-state friction resulting from the res judicata effect of a federal court ruling may warrant abstention if, as in the case of a criminal prosecution, the affected state proceeding is one vindicating important state interests. See *Deakins* v. *Monaghan*, No. 86-890 (Jan. 12, 1988) slip op. 4-5; *Samuels* v. *Mackell*, 401 U.S. 66, 72-73 (1971).

[21] The Council's lawsuit appears unnecessary because, according to the "Home Rule Charter for the City of New Orleans," the Council's rate orders "go into effect at such time as may be fixed by the Council and shall remain in effect and be complied with, unless and until changed, set aside or suspended by the Council or by a court of competent jurisdiction" (§ 4-1604); the Council resolution challenged in this case was made "effective as of the date of issuance of this resolution." In somewhat analogous circumstances, moreover, the Louisiana courts have ruled that, because of the absence of a concrete controversy, governmental entities may not initiate actions for declaratory relief for the purpose of validating their actions. See *Petition of Sewerage & Water Bd.*, 248 La. 169, 175-176, 177 So. 2d 276 (1965); *State* v. *Board of Supervisors*, 228 La. 951, 84 So. 2d 597, 599-600 (1955); *City of Alexandria* v. *Wilks*, 18 So. 2d 341, 344 (La. Ct. App. 1944).

The Council's lawsuit thus shares little in common with the type of state criminal and civil enforcement proceedings that have been held entitled to deference under *Younger*. Indeed, it would seem more akin to the type of first-strike collateral litigation *Younger* was designed to discourage.

Similarly, the state lawsuit filed by the Alliance for Affordable Energy, also within hours of the issuance of the Council's order, is owed no deference under *Younger*. It is principally directed at the Council, not NOPSI, and it raises the wholly subordinate issue whether the Council erred in not denying NOPSI recovery of an even larger proportion of its FERC-mandated share of Grand Gulf costs. Any state interest in that issue, which need be reached only if the Council has not already invaded FERC's exclusive regulatory authority, plainly cannot trump NOPSI's right to choose a federal forum for resolution of the threshold and controlling issue of federal law.

Finally, NOPSI should not be deemed to have triggered *Younger* abstention by its own protective filing of a state court action subsequent to its filing of the instant federal lawsuit. Because of the unsettled nature of the abstention issue, NOPSI was, in effect, compelled to initiate a parallel state court proceeding in order to protect itself against the possibility of federal court abstention after the applicable limitations period had run.[22] Action taken by

[22] Significantly, the state law issues being litigated in NOPSI's state court action are, like those raised by the Alliance for Affordable Energy, narrowly focused and entirely secondary to the threshold preemption claim presented by its federal complaint; they concern the validity of the Council's prudence findings and need be reached only if NOPSI's preemption claim is rejected (see pages 11-12 and note 6, *supra*). Moreover, to the extent that NOPSI has since addressed in its state filings the federal preemption issue, which the state court of appeals recently described as "the primary issue to be decided at the trial on the merits of this case" (*NOPSI* v. *The Council of the City of New Orleans, et al.*, No. 88-CA-1369 (4th Cir. La. Ct App., Feb. 16, 1989), slip op. 6), NOPSI did so only after the federal district court dismissed this lawsuit on abstention grounds. See page 12, *supra*.

Finally, abstention should not now be upheld on the ground that the state courts may determine the merits while the federal proceedings are pending, possibly injecting issues of res judicata into any future federal court consideration of the preemption question. See *Huffman* v. *Pursue, Ltd.*, 420 U.S. at 607-608 & n.19. The possibility of such a state ruling need not prevent this Court from addressing the fundamental question whether, at the time of the federal district court's decision, total abstention was appropriate. See *Pennzoil Co.* v. *Texaco, Inc.*, 481 U.S. at 17 ("In this opinion, we have addressed the situation that existed on the morning of December 10, 1985, when this case was filed in the United States District Court for the Southern District of New York."). Any issues of res judicata that may arise after that time may properly be addressed on remand.

a prudent plaintiff in order to preserve its right to seek relief in some forum should not, perversely, now deprive that plaintiff of the right to have its preference for a federal forum respected.[23]

C. The District Court Should, At The Very Least, Have Considered Whether Interim Injunctive Relief Was Necessary To Prevent Irreparable Harm To Federally Protected Interests Pending Completion Of Any State Court Proceedings On The Preemption Claim

For the reasons described above, we believe that abstention in this case is not warranted. Hence, NOPSI's choice of a federal forum for the resolution of its claim of preemption should be honored. If it is determined, however, that limited abstention is appropriate, we submit that the district court nonetheless erred by failing to con-

[23] Presumably, NOPSI could choose to dismiss voluntarily its state court action, thereby unilaterally eliminating that parallel state proceeding.

sider NOPSI's request for *preliminary* injunctive relief. That request, based solely on a claim of irreparable injury to a protected federal interest, should be entertained by the district court. For if, as NOPSI claims, the denial of interim relief may, as a practical matter, result in the permanent "trapping" of FERC-allocated costs and thus in the frustrating of federal policy, then such relief is necessary to vindicate that policy.[24] At the same time, the granting of interim relief would not, in itself, interfere with the ability of state tribunals to decide NOPSI's claims on their merits. It would only prevent the infliction of irreparable harm in the meantime.

The value of interim federal relief in cases appropriate for abstention is elaborated in a thoughtful article by Professor Wells, *Preliminary Injunctions and Abstention: Some Problems in Federalism*, 63 Cornell L. Rev. 65 (1977). After careful analysis, Professor Wells concludes that when a balance of the interests involved warrants the prevention of irreparable injury—even when abstention is called for—

> [I]nterim relief, rather than refusal to abstain or abstention coupled with condolences for the plaintiff,

[24] Certainly NOPSI's experience in this litigation supports its claim. As *NOPSI I* vividly illustrated, a utility's liability for wholesale rates may be immediate and ongoing, and a delay in passing on those costs through retail rates will often have consequences that are irreparable; it may create immediate cash flow problems and uncertainties that threaten bankruptcy, impede securities offerings, and force compromise settlements (see pages 6, 9, *supra*). Abstention without consideration of appropriate preliminary relief may contribute to, and even precipitate this result. Indeed, for this reason, respondent's reliance (Br. in Opp. 25) on the availability of this Court's eventual review of any state court ruling, even if such review could be assured (see note 15, *supra*), is misplaced. (As noted above, the state courts have so far denied NOPSI's request for preliminary relief. See page 12, *supra*.)

> may offer courts the most appropriate response. Interim relief can and should accommodate both the policies served by abstention and the plaintiff's interests in vindicating constitutional rights.

Id. at 82.

Such limited abstention would not be novel. In related contexts, this Court and lower courts have previously recognized or endorsed the appropriateness of a limited form of abstention, coupled with preliminary relief, in order to avoid irreparable harm. See, *e.g.*, *Babbitt* v. *United Farm Workers*, 442 U.S. 289, 312 n.18 (1979) ("this is a matter that is best addressed by the District Court in the first instance");[25] *Romany* v. *Colegio de Abogados de Puerto Rico*, 742 F.2d 32, 45 n.13 (1st Cir. 1984); *Spartacus, Inc.* v. *Borough of McKees Rocks*, 694 F.2d 947, 949 & n.3 (3d Cir. 1982); *Catrone* v. *Massachusetts State Racing Comm'n*, 535 F.2d 669, 672 (1st Cir. 1976); *Cox Cable Communications, Inc.* v. *Simpson*, 569 F. Supp. 507, 515-522 (D. Neb. 1983); cf. *Leiter Minerals, Inc.* v. *United States*, 352 U.S. 220 (1957) (upholding injunction against prosecution of state action to determine title but staying federal proceeding until state court interpretation of state law could be obtained); *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970).[26] See also P. Bator, D.

[25] The question of preliminary relief presented in this case is, of course, different from that raised in *Pennzoil*. Texaco's entire federal claim in that case was that it was constitutionally entitled to a stay of the trial court's judgment pending appeal; hence, a federal court decision in Texaco's favor would have disposed of the very issue held appropriate for abstention.

[26] In *Pike*, this Court concluded that "[i]n view of the emergency situation presented, and the fact that only a narrow and specific application of the [state statute] was challenged as unconstitutional," a federal district court had been "fully justified in not abstaining from the exercise of its jurisdiction pending litigation in the state courts" and in granting a preliminary injunction (397 U.S. at 140 n.3). The

Meltzer, P. Mishkin & D. Shapiro, *Hart & Wechsler's The Federal Courts and the Federal System* 1375, 1422-1423 (3d ed. 1988); Laycock, *Federal Interference with State Prosecutions: The Need for Prospective Relief*, 1977 Sup. Ct. Rev. 193, 237-238.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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federal plaintiff in *Pike* faced the "imminent loss of its anticipated 1968 cantaloupe crop in the gross amount of $70,000" (*id.* at 140). Although the Court in that case was reviewing a district court's refusal to abstain at all, the same considerations that supported that refusal would surely have supported a decision to abstain only in part.

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No. 88-348

In the Supreme Court of the United States

October Term, 1988

NEW ORLEANS PUBLIC SERVICE, INC.,
Petitioner

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, et al.
Respondents

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

AMICUS CURIAE BRIEF IN SUPPORT OF RESPONDENTS ON BEHALF OF THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

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QUESTION PRESENTED

Whether a federal district court may refrain under the abstention doctrines of *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), or *Younger v. Harris*, 401 U.S. 37 (1971), from exercising its jurisdiction to hear a federal claim when adjudication of that issue would intrude upon or otherwise disrupt a state's lawful regulation of retail utility rates and when the state regulatory scheme provides for adequate relief for state and federal claims.

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Interest of Amicus Curiae

No. 88-348

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1988

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, et al.
Respondents

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

AMICUS CURIAE BRIEF IN SUPPORT OF RESPONDENTS ON BEHALF OF THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

INTEREST OF AMICUS CURIAE

The Pennsylvania Legislature has conferred broad powers upon the Pennsylvania Public Utility Commission (hereafter "Pennsylvania Commission" or "PaPUC") to regulate public utilities in the Commonwealth. The PaPUC has plenary authority and exclusive statewide jurisdiction over the rates and services of Pennsylvania public utilities. 66 Pa. C. S. §§501, 1301, and 1501. As the PaPUC has been charged by the Legislature with the responsibility of regulating public utilities, it is of great import to the Pennsylvania Commission that it, and the Commonwealth courts of review above it, be unfettered in the ability to interpret questions of state law and policy and to exercise their lawful jurisdiction over regulated public utilities. As such the PaPUC supports Respondents, The Council of the City of New Orleans, *et al.*, and urges this Court to affirm the decision below.

The Pennsylvania Commission has requested, and been granted, the consent of Petitioner, New Orleans Public Service, Inc., and Respondents, to its status as an amicus curiae. Pursuant to Rule 36.2 of this Court, the letters of consent are being filed with the Clerk this day under separate cover.

SUMMARY OF ARGUMENT

While the abstention doctrines of *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), and *Younger v. Harris*, 401 U.S. 37 (1971), have developed as supposedly distinct principles, they are nonetheless. quite closely related. Intertwined in both doctrines is an underlying animus against interference whenever possible in state affairs. The Pennsylvania Commission submits that in the area of setting retail utility rates, where the states have a long tradition of administrative regulation coupled with judicial review—a tradition which, for most states, pre-dates that of the federal government in regulatory affairs—federal district courts are correct in abstaining from exercising jurisdiction. To do otherwise is to disturb the orderly regulation of utilities by the states.

In order that its brief be as concise as possible in conformity with this Court's rules, the PaPUC will deal only with the narrow aspect of law set forth above. Additionally the Pennsylvania Commission accepts the Counterstatement of of the case as set forth by Respondents, Council of the City of New Orleans, *et al.* (hereafter "Council").

ARGUMENT

The District Court Correctly Abstained From Exercising Its Jurisdiction To Hear A Federal Claim Pursuant To The Abstention Doctrines of *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), And *Younger v. Harris*, 401 U.S. 37 (1971), In That Adjudication Of That Claim Would Intrude Upon Or Otherwise Disrupt Louisiana's Lawful Regulation Of Retail Utility Rates

The abstention doctrines of *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), and *Younger v. Harris*, 401 U.S. 37 (1971), have developed in the federal courts out of a respect for the states' judicial and administrative processes. This is particularly true in the area of public utility regulation. While federal regulation of wholesale energy transactions or interstate telecommunications and state regulation of retail energy rates and local telephone service do occasionally overlap, these are distinct jurisdictions separated by a "bright line."[1]

This Court was explicit in its recognition of this differentiation in *Burford*. *Burford* involved the regulation of oil fields by the state of Texas. The state had an interest in seeing that the fields were conserved and not quickly depleted, an area of regulation which the federal government had left to the states. *Burford* at 319. The federal court had been requested to enjoin an order of the Texas Rail-

[1] *See Nantahala Power & Light Co. v. Thornburg, et al.*, 476 U.S. 953 (1986).

road Commission on the basis of diversity of citizenship and a due process claim. The Court's decision to abstain was affirmed by the Circuit Court of Appeals and this Court.

This Court noted that the Texas regulatory scheme was of "vital interest to the general public," and included a system of "thorough judicial review." *Id*. at 324-325. The Court found that this was not a system into which the federal courts should interpose their authority lightly:

> "Few public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with state policies, ... These cases reflect a doctrine of abstention appropriate to our federal system whereby the federal courts, 'exercising a wise discretion', restrain their authority because of 'scrupulous regard for the rightful independence of the state governments' and for the smooth working of the federal judiciary ... . This use of equitable powers is a contribution of the courts in furthering the harmonious relation between state and federal authority without the need of rigorous congressional restriction of those powers."

Id. at 332-333, citing *Railroad Commission v. Pullman Co.*, 312 U.S. 496, 500-501 (1941).

The Court held that abstention was appropriate when there was a "unified method" of establishing policy and deciding cases by the regulatory commission and state courts, and the state system provided for "expeditious and adequate" judicial review. *Burford* at 333-334. The Court noted that federal claims could still reach it through the state appellate process. It warned that "[c]onflicts in the interpretation of state law, dangerous to the success of state

policies, are almost certain to result from the intervention of the lower federal courts." *Id*. at 334.

The actual presence of a question of state law is not critical to abstention as the Court explained many years later in discussing *Burford:*

> In some cases, however, the state question itself need not be determinative of state policy. It is enough that exercise of federal review of the question in a case and in similar cases would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern.

Colorado River Water Conservation District v. United States, 424 U.S. 800, 815 (1976).

The Court expressed this same conviction in deciding *Younger v. Harris*, 401 U.S. 37 (1971), where it reversed a district court order enjoining a state prosecution. The Court noted that the Framers of the Constitution in developing the concept of "Our Federalism," envisioned a government where the interests of both the central government and the states are recognized. *Younger* at 44. While rejecting blind deference to states' rights, the Framers created a system where the central government, "anxious though it may be to vindicate and protect federal rights and federal interests, always endeavors to do so in ways that will not unduly interfere with the legitimate activities of the States." *Id*. This two-way respect has become known as the tenet of comity.

Abstention under the *Younger* doctrine is appropriate where: (1) there are ongoing state judicial proceedings, (2) the proceedings involve an important state interest, and (3) there is an adequate opportunity to raise constitutional

challenges in the state proceedings. *Middlesex County Ethics Committee v. Garden State Bar Assoc.*, 457 U.S. 423, 432 (1982). The *Younger* doctrine is not limited to criminal proceedings but extends to any proceeding "when important state interests are involved." *Id*. *Younger*, and the cases that followed it, express a definite proclivity against Federal Court intervention in ongoing state judicial proceedings except in extraordinary circumstances. *Id*.

Petitioner New Orleans Public Service, Inc. (hereafter "NOPSI"), has urged the Court to reverse because, among other things, no state law is at issue and its complaint rests solely on federal grounds. Petitioner's Brief at 13. The Pennsylvania Commission submits that, as this Court said in *Colorado Water Dist*., the intrusion into a state regulatory scheme is enough to cause disruption in the state's administration of utility rates. The PaPUC further submits, based upon its own experience, that this can trigger unintended results.

On May 31, 1984, the Governor of Pennsylvania approved comprehensive legislation regarding the recovery of gas costs for natural gas distributors with gross revenues in excess of $40 million; Act 1984-74 ("Act 74"), codified at 66 Pa. C. S. §§1307, 1317, 1318 and 2107. Act 74 mandates that each utility subject to its provisions shall pursue a "least cost fuel procurement policy." 66 Pa. C. S. §1318(a)(1)-(4). Like many states, Pennsylvania allows natural gas and electric utilities to recover the costs of fuel on a timely basis without filing a complete rate case each time an adjustment is necessary. Instead, each utility's fuel purchases are reviewed in an annual hearing.

Equitable Gas Company (hereafter "Equitable") is a natural gas distributor subject to the jurisdiction of the

PaPUC. It is a division of Equitable Resources, Inc., which also includes Kentucky West Virginia Gas Company, an affiliated interstate pipeline supplier to Equitable prior to 1988.

Following its first hearing under Act 74 the Pennsylvania Commission disallowed a portion of Equitable's fuel expenses for the period of July 1983 through June 1984 because it had purchased gas from its affiliate, Kentucky West, when less expensive gas was available from other sources in violation of Section 1318(b). The case was subsequently appealed to the Pennsylvania Commonwealth Court which affirmed the Pennsylvania Commission's decision. *Equitable Gas Company v. Pennsylvania Pub. Util. Comm.*, 106 Pa. Commonwealth Ct. 240, 526 A.2d 823 (1987).

At the same time, Equitable also filed a complaint with the U.S. District Court for the Middle District of Pennsylvania. *Kentucky West Virginia Gas Co., et al. v. Pennsylvania Pub. Util. Comm., et al.*, 620 F. Supp. 1458 (M.D. Pa. 1985). Equitable sought a preliminary and permanent injunction and declaratory judgment against the PaPUC and its individual members claiming that the commission's order and certain parts of Act 74 violated the commerce clause, supremacy clause and the first, fifth and fourteenth amendments to the U.S. Constitution.[2] The PaPUC and the (Pennsylvania) Office of the Consumer Advocate, an intervening defendant, argued, among other things, that the Court should abstain from exercising its jurisdiction pursuant to *Burford*.

[2] U.S. Const. art. I, §8, cl. 3; U.S. Const. art. VI, cl. 2; and U.S. Const. amend. I, V, and XIV, §1.

The Court agreed, finding that its intervention would be disruptive of the state's efforts to regulate utilities. *Id.* at 1461. The Court concluded, *sua sponte*, that the three criteria for abstention under *Younger* were also present. *Id.* at 1462. The decision to abstain was appealed to the Third Circuit which reversed and remanded the case to the District Court for trial. *Kentucky West Virginia Gas Co. et al. v. Pennsylvania Pub. Util. Comm. et al.*, 791 F.2d 1111 (3rd Cir. 1986).

The Third Circuit held that the *Burford* abstention is in doubt where substantial questions of federal preemption are involved even though the Court was aware that its decision would disrupt the regulatory scheme in Pennsylvania. *Id.* at 1115-1116. *Younger* abstention was also inappropriate. The Court stated that the mere existence of state judicial proceedings is not enough to justify abstention when state interests are foreclosed or preempted by the Constitution. *Id.* at 1116-1117.

Following a trial on the merits the District Court found in favor of the Pennsylvania Commission and the constitutionality of Act 74. *Kentucky West Virginia Gas Co., et al. v. Pennsylvania Pub. Util. Comm. et al.*, 650 F. Supp. 659 (M.D. Pa. 1986). Its findings were ultimately affirmed by the Third Circuit. *Kentucky West Virginia Gas Co., et al. v. Pennsylvania Pub. Util. Comm. et al.*, 837 F.2d 600 (3rd Cir. 1988) *cert. denied*, U.S. , 109 S.Ct. 365 (1988).

Following the Pennsylvania Commission's decision in its 1986 Act 74 proceeding, Equitable appealed to the state courts while filing an action in federal court again raising supremacy clause and commerce clause claims. *Kentucky West Virginia Gas Co. v. Pennsylvania Pub. Util.*

Comm., 862 F.2d 69 (3rd Cir. 1988). In an unreported decision, the District Court for the Middle District of Pennsylvania reversed the PaPUC in part. The Third Circuit reversed the District Court and held again that Act 74 violated neither the commerce nor supremacy clauses of the Constitution. *Id.* at 72-74.

Equitable took no appeal of the PaPUC's order following its 1987 annual review of fuel purchases, nor did it file a complaint in federal court.

However, following the PaPUC's order in Equitable's 1988 Act 74 proceeding, Equitable appealed the commission's decision to the Pennsylvania Commonwealth Court. That appeal is pending at Docket No. 2324 C.D. 1988. The company has again filed a complaint in Federal District Court alleging preemption and other constitutional violations. U.S. District Court for the Middle District of Pennsylvania Case No. CV 89-0124.

The Pennsylvania Commission understands the federal courts' desire to determine important questions of federal law. However, when the district courts intervene in such matters it has a discouraging effect upon the state regulatory mechanism. In addition to having to continually defend actions in federal court, the pending federal actions keep the state regulators, as well as the regulated industry, unsure of the challenged state law. This results in regulation which must remain uncertain pending litigation for long periods of time.

For example, after the District Court reversed in part the PaPUC's 1986 Act 74 order regarding Equitable's gas purchases, it became necessary for the Commission to alter procedures for all utilities subject to Act 74.

By Secretarial Letter dated April 11, 1988, the Commission notified the Company that the Commission had instituted an investigation to determine the lawfulness of the rates proposed in the supplements pursuant to the requirements of Section 1307(f)(2) of the Public Utility Code. The investigation was opened at R-880958 and assigned to Administrative Law Judge Herbert Smolen. The Commission also directed PG&W, as follows:

'We wish to call to the attention of all parties and the Office of Administrative Law Judge, an order issued October 26, 1987, in the case of Kentucky West Virginia Gas Company, et al. v. Pennsylvania Public Utility Commission, Civil Action No. 86-1380, United States District Court for the Middle District of Pennsylvania, Slip Opinion, October 16, 1987. This order made final a previous order by the Court dated July 13, 1987, which inter alia, found the Commission practice of employing projections of wholesale gas rates regulated by the Federal Energy Regulatory Commission, in the setting of prospective gas cost rates to be violative of the Supremacy Clause of the U.S. Constitution. This order is currently on appeal to the U.S. Court of Appeals for the Third Circuit. Resolution of this issue may not occur prior to the close of the record in this proceeding. Therefore, Pennsylvania Gas & Water Company is directed to modify, if necessary, its projections of future gas costs so as to adhere to rates as stated in currently effective Federal Energy Regulatory Commission tariffs. The parties are reminded that updates relating to changes in purchased fuel expense must be received no later than thirty (30) days prior to the close of the record.'

Pennsylvania Pub. Util. Comm. v. Pennsylvania Gas and Water Co., 1988 Pa. PUC LEXIS 460, 40-41 (September 30, 1988) (citation omitted). When the Third Circuit restored the Pennsylvania Commission's order, procedures had to be adjusted again.

It cannot be that the state courts are unable to consider federal questions. Recently this Court affirmed an opinion of the Pennsylvania Supreme Court which found lawful a state statute which excluded for ratemaking purposes expenditures by electric utilities for generation facilities which were planned but never built even though the expenditures were reasonable when made. *Duquesne Light Co. v. Barasch, et al.*, U.S. , 109 S.Ct. 609 (1989). The Pennsylvania Supreme Court, in reversing a PaPUC decision, held that the law did not take the utilities' property in violation of the fifth amendment to the Constitution. *Id.*, 109 S.Ct. at 614.

The statute upon which that decision turned was tested in the state administrative and judicial system. However, Act 74, which involves the recovery of fuel acquisition costs, has been and remains the subject of review in the federal court system. The federal courts, whether through intention or misadventure, have become a part of the state regulatory system in Pennsylvania. This runs contra to *Burford*, *Younger*, and their progeny wherein the Court has evidenced a respect for state judicial and administrative systems. Such respect would allow a state agency or court the opportunity to reconcile its action or underlying statute with federal law before a federal court intervenes.

As the Fifth Circuit noted in *New Orleans Public Service, Inc. v. the City of New Orleans, et al.*, 798 F.2d 858 (5th Cir. 1986), the District Court correctly concluded that

to exercise its jurisdiction would be to intrude upon a complex state regulatory system. *Id.* at 861-862. The Court was aware that the Louisiana judicial system would be fully able to adjudicate any complaint NOPSI might have with an order of the City Council. The Court concluded that *Burford* abstention was appropriate. *Id.*

The Court also found that conditions to justify abstention under *Younger* were also present. *Id.* at 863-864. Applying the three criteria explained in *Middlesex County*, the Court stated that the administrative proceeding before the Council was an ongoing judicial proceeding in that it was within the appellate jurisdiction of the Louisiana courts, the interest of the Council in setting retail electric rates was "clearly important" and a matter reserved to the states, and that NOPSI would have a full and fair opportunity to litigate any federal claims through the appellate process. *Id.* Additionally, there was no evidence of "bad faith, harassment or other exceptional circumstances." *Id.*

When this matter returned to the Fifth Circuit (for the third time), the Court noted that there had been no important change in circumstance since its 1986 decision. *New Orleans Public Service, Inc. v. The City of New Orleans, et al.*, 850 F.2d 1069 (5th Cir. 1988). The main difference was that by 1988 Council had completed its investigation into NOPSI's Grand Gulf I involvement. *Id.* at 1079. NOPSI still had the opportunity for judicial review in the state courts before it, and it has filed such an appeal. Therefore, the Fifth Circuit correctly affirmed the District Court's decision to abstain upon the same grounds as it had in its 1986 opinion.

NOPSI argues that federal preemption precludes even the consideration of this matter in the state courts.

Petitioner's Brief at 2, 13. In arguing against abstention under the *Younger* doctrine, NOPSI states that abstention is inappropriate "when the invalidity of the state proceeding and order is clear on its face." *Id*. at 35-38. This is nothing more than a request to rule on the merits of NOPSI's preemption claim and is out of place in an appeal on abstention.

This Court has already rejected this reasoning in *Younger* where it explained an earlier decision[3] which seemed to condone such action:

> The District Court, however, thought that the Dombrowski decision substantially broadened the availability of injunctions against state criminal prosecutions and that under that decision the federal courts may give equitable relief, without regard to any showing of bad faith or harassment, whenever a state statute is found "on its face" to be vague or overly broad, in violation of the First Amendment. We recognize that there are some statements in the Dombrowski opinion that would seem to support this argument. But, as we have already seen, such statements were unnecessary to the decision of that case, because the Court found that the plaintiffs had alleged a basis for equitable relief under the long-established standards.

Younger at 50.

Granting of NOPSI's appeal on these grounds will open the door to federal court challenges to state regulatory laws and orders. Such "on its face" review will result in placing at least some of the power to abstain, or more likely the power to refrain from such action, in the hands of the person who drafts the complaint.

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[3] *Dombrowski v. Pfister*, 380 U.S. 479 (1965).

CONCLUSION

However this Court rules, the Pennsylvania Commission wants it to be aware that its decision will be felt in administrative agencies and courts throughout the country. When the proper safeguards and remedies of judicial review are present, the state courts should be allowed to review the impact of state laws or regulatory schemes may have upon federal claims. The Court is urged to affirm.

Respectfully submitted,

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IN THE
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NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF THE NATIONAL LEAGUE OF CITIES, NATIONAL CONFERENCE OF STATE LEGISLATURES, UNITED STATES CONFERENCE OF MAYORS, INTERNATIONAL CITY MANAGEMENT ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, AND COUNCIL OF STATE GOVERNMENTS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether a federal court should abstain from adjudicating a claim that relates to an intrastate retail ratemaking currently under review in the state courts.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-348

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF THE NATIONAL LEAGUE OF CITIES, NATIONAL CONFERENCE OF STATE LEGISLATURES, UNITED STATES CONFERENCE OF MAYORS, INTERNATIONAL CITY MANAGEMENT ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, AND COUNCIL OF STATE GOVERNMENTS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

INTEREST OF THE *AMICI CURIAE*

The *amici* are organizations whose members include state, county, and municipal governments and officials throughout the United States. They have a compelling and continuing interest in the issue presented here: whether the jurisdiction of the federal courts may be invoked to pretermit state regulatory processes.

This case follows upon a proceeding before the Federal Energy Regulatory Commission (FERC) to allocate power produced by the Grand Gulf I nuclear facility among the members of the Middle South Utilities, Inc. (MSU) system, one of which is petitioner. See *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 108 S.Ct. 2428

(1988). Following FERC's determination, respondent initiated a review to set petitioner's intrastate retail rates. During the course of that review, respondent (the Council of the City of New Orleans) expressly disavowed any intention of challenging the prudence of petitioner's decision to participate in the Grand Gulf project, and fully accepted both the interstate rates set and the allocation of Grand Gulf power made by FERC. Respondent found, however, that petitioner's management had been imprudent in 1979-1980 when it failed to diversify its risks by selling a portion of its Grand Gulf I power off-system. Respondent accordingly concluded that petitioner should not be permitted to pass on certain Grand Gulf costs to retail customers. Petitioner challenges this determination as inconsistent with FERC's order and with this Court's decision in *Mississippi Power*.

Petitioner had an opportunity to raise its preemption claim before respondent, which in fact closely considered the preemption issue and limited its order in light of the FERC opinion. Petitioner also may litigate its preemption arguments before the Louisiana courts as part of the regular process of administrative review; indeed, there are now three proceedings related to respondent's order pending in the state courts. Petitioner nevertheless brought this action in federal district court, seeking a preliminary injunction against respondent's rate order and a resolution of the preemption claims. The district court and the court of appeals instead abstained, holding that review of respondent's action should proceed in the state courts. Petitioner then brought the case to this Court.

Amici and their members have a significant practical interest in the abstention rules that the Court will address in this case. Retail ratemaking for electric utilities is a matter of profound concern to States, local governments, and all of their citizens. And the setting of rates is a matter that requires both administrative expertise and a familiarity with local conditions. Allowing federal courts to insert themselves into ongoing rate proceedings would disturb that delicate process. It also would cast aspersions on the competence of state courts to adjudicate federal issues. For these reasons, *amici* submit this brief to assist the Court in the resolution of this case.[1]

SUMMARY OF ARGUMENT

1. Under *Younger v. Harris*, 401 U.S. 37 (1971), and its progeny, federal courts should decline jurisdiction when they are asked to take action that will interfere with "[1] state administrative proceedings in which [2] important state interests are vindicated, so long as [3] in the course of those proceedings the federal plaintiff could have a full and fair opportunity to litigate his constitutional claim." *Ohio Civil Rights Comm'n v. Dayton Christian Schools, Inc.*, 477 U.S. 619, 627 (1986). When these factors are present, abstention is "'the *normal* thing to do.'" *Ibid.* (emphasis in original) (quoting *Younger*, 401 U.S. at 45). Petitioner does not deny that the first and third of these prerequisites are present here. And the second plainly is as well. Protecting the integrity of the processes of administrative review is itself an important state concern. At the same time, the underlying state interest in the regulation of utilities, which "is one of the most important of the functions traditionally associated with the police power of the States" (*Arkansas Electric Cooperative Corp. v. Alabama Public Service Comm'n*, 461 U.S. 375, 377 (1983)), is plainly substantial enough to warrant abstention.

Petitioner nevertheless argues that the courts below should not have abstained because respondent's order is assertedly inconsistent with this Court's decision in *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 108 S.Ct. 2428 (1988). But federal courts should not forgo abstention and pretermit state court litigation sim-

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[1] The parties have consented to the filing of this brief pursuant to Rule 36 of the Rules of this Court. Their letters of consent have been filed with the Clerk of the Court.

ply because a state agency or trial court makes what is asserted to be a plain error of federal law; such a result would in equal parts disrupt and insult the state adjudicative process, while denying "the State an opportunity to 'set its own house in order.'" *Ohio Bureau of Employment Services v. Hodory*, 431 U.S. 471, 479-480 (1977). In any event, petitioner grossly overstates its case in asserting that respondent's order is inconsistent with *Mississippi Power*. In its decision there, the Court held only that States may not challenge FERC-ordered allocations of Grand Gulf power. But respondent here fully accepted petitioner's obligation to purchase its FERC-allocated share of power from Grand Gulf; respondent concluded that petitioner was imprudent in failing to diversify its risks by selling a portion of the Grand Gulf power *off-system*. The propriety of such an order is simply not addressed in *Mississippi Power*, and it should not be addressed in the first instance during the course of a federal court's abstention analysis.

Petitioner is equally incorrect in asserting that abstention always is inappropriate when the federal claim is one of preemption. If respondent erred in its interpretation of the Federal Power Act, that mistake, like any other error of federal constitutional or statutory law, may be remedied on appeal to the state courts. Surely state judges will be no less willing to enforce federal statutory than federal constitutional claims (as to which abstention plainly is appropriate), and surely the federal Government's interest in the effectuation of constitutional rights is no weaker than its interest in the vindication of statutorily created programmatic concerns.

For his part, the Solicitor General offers a series of arguments that cannot bear substantial weight. This is not an "interstate dispute," as the Solicitor General suggests; respondent's proceeding, which did not disturb FERC's allocation of Grand Gulf power within the MSU system,

concerned only intrastate retail rates, a matter that has no conceivable bearing on the interests of other States. It is irrelevant that this case involves a request for declaratory rather than injunctive relief, since "the declaratory relief alone has practically the same practical impact as a formal injunction would." *Samuels v. Mackell*, 401 U.S. 66, 72 (1971). And the nature of the suit that petitioner filed in state court has no bearing on the abstention question: a necessary concomitant of *Younger* is that a party must exhaust its state appellate remedies before seeking relief in federal court. *Huffman v. Pursue, Ltd.*, 420 U.S. 592, 609 (1975).

2. *Burford* abstention is proper when the exercise of the district court's jurisdiction would disrupt an ongoing state administrative proceeding; there need not be an unsettled issue of state law in the case. *Alabama Public Service Comm'n v. Southern Ry. Co.*, 341 U.S. 341 (1951). This case falls squarely within that rule. Almost by definition, intervention by the federal courts at this stage of the proceeding would disrupt the administrative process by precluding state court consideration of the regulatory issues. And choosing among rate structures is a matter of paramount local concern that demands the application of local administrative expertise.

3. Finally, petitioner and the Solicitor General are incorrect in arguing that, even if abstention is otherwise appropriate, the district court should have determined the availability of preliminary injunctive relief. That argument was at least implicitly rejected in *Doran v. Salem Inn, Inc.*, 422 U.S. 922 (1975). And it is inconsistent with the principles of *Younger* and *Burford*. Those doctrines presume that state courts are willing and able to enforce federal rights; if state courts are trusted to resolve federal claims for all time by issuing final judgments on the merits, surely they may be trusted to decide questions of interim relief.

ARGUMENT

THE COURTS BELOW PROPERLY ABSTAINED IN THIS CASE

Petitioner and the Solicitor General suggest that the courts below did something extraordinary, observing that abstention is unusual and that federal courts generally hear the cases that fall within their jurisdiction. There is something to this, of course: in the vast universe of cases, the ones in which abstention is proper are comparatively rare.[2] But when the prerequisites for abstention are present—in particular, when the federal court is asked to interfere with ongoing state judicial or administrative proceedings—there are "strong policies counseling against the exercise of [federal] jurisdiction" that make abstention "'the *normal* thing to do.'" *Ohio Civil Rights Comm'n v. Dayton Christian Schools, Inc.*, 477 U.S. 619, 626, 627 (1986) (emphasis in original) (quoting *Younger v. Harris*, 401 U.S. 37, 45 (1971)). This is such a case.

The decisions below rest on two forms of abstention that, like abstention doctrines generally, "reflect a complex of considerations designed to soften the tensions inherent in a system that contemplates parallel judicial processes." *Pennzoil Co. v. Texaco Inc.*, 481 U.S. 1, 11 n.9 (1987). *Younger* abstention, in Justice Black's famous words, is grounded on "'comity,' that is, a proper respect for state functions, a recognition of the fact that the entire country is made up of a union of separate state governments, and a continuance of the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways." *Younger*, 401 U.S. at 44. The *Younger* doctrine thus reflects the Court's conclusion that federal interference with state

[2] But it is not, perhaps, as rare as petitioner and the Solicitor General suggest. See generally Shapiro, *Jurisdiction and Discretion*, 60 N.Y.U.L.Rev. 543 (1985).

proceedings "not only 'unduly interfere[s] with the legitimate activities of the Stat[e],' *Younger*, [401 U.S.] at 44, but also 'can readily be interpreted "as reflecting negatively upon the state court's ability to enforce constitutional principles."'" *Juidice v. Vail*, 430 U.S. 327, 336 (1977) (quoting *Huffman v. Pursue, Ltd.*, 420 U.S. 592, 604 (1975)). *Burford* abstention, first articulated in *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), is based on similar "grounds of comity with the States when the exercise of jurisdiction by the federal court would disrupt a state administrative process." *County of Allegheny v. Frank Mashuda Co.*, 360 U.S. 185, 189 (1959). The decisions below are entirely unexceptional applications of both doctrines.

I. *YOUNGER* ABSTENTION IS PROPER IN THIS CASE

The prerequisites to *Younger* abstention have become familiar. Under *Younger* and its progeny, federal courts should decline jurisdiction when they are asked to take action that will interfere with "[1] state administrative proceedings in which [2] important state interests are vindicated, so long as [3] in the course of those proceedings the federal plaintiff could have a full and fair opportunity to litigate his constitutional claim." *Dayton Christian Schools*, 477 U.S. at 627. See *Middlesex County Ethics Comm. v. Garden State Bar Ass'n*, 457 U.S. 423, 432 (1982). If these three elements are present, a federal court may decline to abstain only if the case involves a challenge to a statute that "is flagrantly and patently violative of express constitutional prohibitions in every clause, sentence and paragraph, and in whatever manner and against whomever an effort might be made to apply it" (*Moore v. Sims*, 442 U.S. 415, 424 (1979) (citations and internal quotation marks omitted)), if state enforcement authorities are acting in bad faith, or in other undefined "extraordinary" circumstances. See *id.* at 433; *Juidice*, 430 U.S. at 338-339. We address these elements of the *Younger* test in turn.

A. The *Younger* Prerequisites Have Been Met In This Case

1. Neither petitioner nor the Solicitor General denies that the first and third of the *Younger* prerequisites are present here. Nor could they. While the *Younger* doctrine was developed to preclude interference with state courts, the Court has made it clear that *Younger*'s principles also apply to state administrative proceedings that have a judicial aspect. See *Dayton Christian Schools*, 477 U.S. at 627; *Middlesex County Ethics Comm.*, 457 U.S. at 432. Both courts below properly held that the proceedings before respondent, with review in the state courts, were judicial in nature. See Pet. App. 20A, 28A n.8.[3] In any event, there currently are three suits involving respondent's order—including petitioner's own challenge—pending in state court. By the same token, petitioner will have ample opportunity to litigate its preemption claim during the course of those judicial proceedings; claims very similar to petitioner's are routinely resolved by state courts. See *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 964-966 (1986). Indeed, petitioner had an opportunity to raise its federal arguments in the administrative proceedings, where respondent carefully considered the preemption question and tailored its order to avoid inconsistency with FERC's decision. See J.A. 23-24, 52-61.

2. Petitioner does maintain (Br. 28-32) that respondent is unable to establish the second *Younger* prerequisite: the presence of an "important" state interest. In petitioner's view, the only state interest asserted here is respondent's "adjudicatory interest in having its state

[3] "Of course, if state law expressly indicates that the administrative proceedings are not even 'judicial in nature,' abstention may not be appropriate." *Dayton Christian Schools*, 477 U.S. at 628 n.2, citing *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229 (1984). But both courts below—which are familiar with Louisiana law—concluded that "[t]he Council proceeding, followed by the opportunity for state review, * * * constitutes an ongoing judicial proceeding." Pet. App. 20A. See *id.* at 28A n.8.

court resolve federal issues" (Br. 29), which petitioner contrasts with what it describes as a "legitimate substantive state interest" (Br. 30). This contention, in our view, is grounded on a misunderstanding both of the *Younger* doctrine and of respondent's real concerns here.

At the outset, we take issue with petitioner's premise: protecting the integrity of the adjudicatory process—here, the process of state court judicial review of administrative determinations—*is* an important state interest. While the Court has not yet held that *Younger* abstention is necessary *whenever* parallel proceedings are pending in state and federal court (see, *e.g.*, *Pennzoil*, 481 U.S. at 14 n.12), it has indicated that certain adjudicatory interests are themselves "important" within the meaning of *Younger*; abstention is appropriate to forestall federal interference with state judicial proceedings that would "prevent[] the state *not only* from effectuating its substantive policies, but also from continuing to perform the *separate* function of providing a forum competent to vindicate any constitutional objections interposed against those policies." *Huffman*, 420 U.S. at 604 (emphasis added). It is, of course, this consideration that motivated the Court's holdings in *Pennzoil* and *Juidice*, which respectively held abstention appropriate in actions to enjoin execution of a state civil judgment and a judgment of contempt. See 418 U.S. at 12-13; 430 U.S. at 335-336. To the State, using its own courts for the review of administrative decisions is an equally important adjudicatory concern—one important enough, as we explain below (at 22-23), to serve as the principal justification for *Burford* abstention.

In any event, petitioner entirely disregards the existence of a central, substantive state concern in this case: respondent's interest in establishing fair and reasonable rates for the consumers of electric power. The Court itself recently observed that "the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States" (*Arkansas Elec-*

tric Cooperative Corp. v. Arkansas Public Service Comm'n, 461 U.S. 375, 377 (1983); "[t]he State's concern that rates be fair and efficient represents a clear and substantial governmental interest." *Central Hudson Gas & Electric Corp. v. Public Service Comm'n*, 447 U.S. 557, 569 (1980). Cf. *Consolidated Edison Co. v. Public Service Comm'n*, 447 U.S. 530, 549-550 (1980) (Blackmun, J., dissenting); *Frost v. Corporation Comm'n*, 278 U.S. 515, 534-535 (1929) (Brandeis, J., dissenting). For its part, Congress has recognized the importance of these concerns, showing in the Federal Power and Natural Gas Acts a "constant purpose to protect rather than to supervise authority of the states." *Connecticut Light & Power Co. v. Federal Power Comm'n*, 324 U.S. 515, 525 (1945).[4] See *Interstate Natural Gas Co. v. Federal Power Comm'n*, 331 U.S. 682, 690 (1947); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 612 (1944). See also *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 108 S.Ct. 2428, 2447, 2449 (1988) (Brennan, J., dissenting). Indeed, Congress enacted those statutes not to deprive States of ratemaking authority but to close the regulatory gap created by this Court's holdings that the Commerce Clause prohibited the States from regulating the interstate sale of power. See *Arkansas Electric*, 461 U.S. at 377-380; *Connecticut Power*, 324 U.S. at 526-527.

By any measure, the regulation of utilities ranks in importance with the other substantive interests that the Court's decisions have established as "vital" within the meaning of *Younger*: regulation of attorneys (*Middlesex County Ethics Comm. v. Garden State Bar Ass'n, supra*); restriction of pornographic theaters (*Huffman v. Pursue, Ltd., supra*); elimination of sex discrimination (*Ohio Civil Rights Comm'n v. Dayton Christian Schools, supra*); pre-

[4] The Court has interpreted the Federal Power and Natural Gas Acts as "'in all material respects identical.'" *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981) (quoting *Federal Power Comm'n v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956)).

vention of child abuse (*Moore v. Sims, supra*); and other "important state policies such as safeguarding the fiscal integrity of [public assistance] programs." *Trainor v. Hernandez*, 431 U.S. 434, 444 (1977); see *id.* at 448 (Blackmun, J., concurring). Ratemaking is a traditional state function; the "economic aspects of electrical generation have been regulated for many years and in great detail by the States." *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Comm'n*, 461 U.S. 190, 206 (1983) (footnote omitted).[5] And that regulation has a far more profound effect on the lives of a far greater number of people than, for example, the disciplining of attorneys or the regulation of obscenity. Indeed, in this case respondent heard testimony that the rate increase sought by petitioner would have led to the elimination of thousands of jobs and the impoverishment of thousands of families in New Orleans. J.A. 21 & n.2. These concerns are plainly important enough to satisfy the second *Younger* prerequisite.

B. The Exceptions To *Younger* Abstention Do Not Apply

1. Finding that federal involvement would disrupt important state proceedings normally would be the end of the *Younger* inquiry. But petitioner asserts (Br. 35-38) that abstention is improper here because respondent's order is inconsistent with this Court's decision in *Mississippi Power*. That asserted inconsistency, petitioner maintains, brings into play the *Younger* exception for challenges to "flagrantly and patently" unconstitutional statutes (Br. 35 n.41). Underlying this argument is petitioner's contention that *Younger* abstention is inappropriate when a federal court is asked to determine that "a state proceeding or order * * * is invalid on its face" (Br. 35). Again, however, we take issue both with pe-

[5] Many States had created commissions to regulate electric utilities as early as 1920, and every State now has such a regulatory body. *Pacific Gas & Electric*, 461 U.S. at 206 n.17. With the exception of a brief interlude, respondent has regulated petitioner since 1922. Pet. App. 22A.

titioner's legal premise and with its application of that premise to the record here.

First, in our view, the *Younger* exception is not applicable when federal court intervention is sought because a state administrative order or trial court decision, rather than a statute, is said to be "patently unconstitutional." If federal courts are not required to abstain in such circumstances, they could pretermit state lawsuits whenever a state agency or trial court made what was purported to be a plain error of federal law, a result that would be extraordinarily disruptive of the State's adjudicative process. That result also would be singularly inappropriate because it typically is "a judicial system's appellate courts which are by their nature a litigant's most appropriate forum for the resolution of constitutional contentions." *Huffman*, 420 U.S. at 609. And it would fly in the face of *Younger's* principal aim: giving "the State an opportunity to 'set its own house in order' when the federal issue is already before a state tribunal." *Ohio Bureau of Employment Services v. Hodory*, 431 U.S. 471, 479-480 (1977).

Indeed, if it is true that respondent's order is plainly inconsistent with federal law (a point we discuss below), federal intervention is unnecessary; the more patently incorrect the administrative decision, the likelier it is that the state courts will detect and correct the illegality.[6] Petitioner's rule, moreover, would require the federal courts to resolve the merits of claims that are ongoing in state court before deciding to abstain, a wasteful and duplicative process that is illustrated by the heated arguments exchanged by the parties here about the merits of respondent's decision.[7]

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[6] Cf. P. Bator, D. Meltzer, P. Mishkin & D. Shapiro, *Hart & Wechsler's The Federal Courts and the Federal System* 1403 (3d ed. 1988) ("Isn't it a particular insult to the state courts to suggest that they will be unable to detect patent unconstitutionality in state statutes?").

[7] As the court of appeals explained, "[w]hen a federal court decides to abstain, it does not decide to keep federal hands off only so long as the state agency behaves as the court thinks proper. Instead, it decides not to interfere at all, leaving to the state agency, the state courts, and, ultimately, the United States Supreme Court, the interpretation of both state and federal law and the ultimate protection of the federal constitution." Pet. App. 18A-19A.

2. Having said this, we feel bound to accept petitioner's invitation to discuss the substance of the preemption claim: we think it clear that petitioner's submission on the merits is grossly overstated, and that it is at worst an open question whether respondent's order is preempted by FERC's determinations in the Grand Gulf proceeding. In *Mississippi Power*, upon which petitioner principally relies, the Court concluded that FERC had implicitly settled the propriety both of the decision to construct Grand Gulf I and of the agreements between participants in the Middle South Utilities, Inc. (MSU) system. See 108 S.Ct. at 2434-2435, 2441. The Court therefore held that a state utility commission could not reconsider the prudence of the system-wide agreements, of the FERC-ordered allocations of Grand Gulf power, or of a utility's decision to be a party to the construction and operation of Grand Gulf I. See *id.* at 2441.

Because the state court in *Mississippi Power* had ordered a state commission to consider the prudence of the decision to construct Grand Gulf I (see *id.* at 2347) and therefore sought "to permit the State to set rates based on an assumption that [the utility] is obligated to purchase less Grand Gulf power than FERC has ordered it to purchase" (*id.* at 2439), the Court held that the state ruling was inconsistent with FERC's order. See *id.* at 2440. "[I]t obviously cannot be unreasonable," the Court held, "for [the utility] to procure the particular quantity of high-priced Grand Gulf power that FERC has ordered it to pay for." *Ibid.* At the same time, however, the Court recognized that it might be unreasonable for a utility to obtain high-cost power—even at a FERC-approved rate—if the utility were able to obtain substi-

tute low-cost power from an alternative source. See *id.* at 2440; *Nantahala*, 476 U.S. at 972. See also *id.* at 967 (wholesale and retail rates may diverge if costs other than those "resulting from the purchase of FERC-regulated power or gas were to decrease").

In this case, respondent challenged neither the allocation of Grand Gulf power to petitioner nor the prudence of the decision to construct Grand Gulf I, the points that this Court's opinion in *Mississippi Power* held to have been resolved by FERC. To the contrary, respondent's Prudence Resolution "expressly stated that '[t]he Council will not seek to invalidate any of the agreements surrounding Grand Gulf I or to order NOPSI to pay MSU a rate other than that approved by the FERC.'" J.A. 54. And respondent's order expressly disclaimed any intention to "adopt a different allocation formula as the basis for retail rates than that adopted by the FERC for wholesale rates," explaining that "such an action would * * * violate the Supremacy Clause." J.A. 58. Indeed, while respondent in fact held the view that petitioner's commitment to Grand Gulf I was imprudent, it explained that, "[b]ecause of the FERC's determination, which legally established NOPSI's share of Grand Gulf I, we do not * * * alter or interfere with that allocation or base any monetary remedy on the foregoing finding of imprudence." J.A. 23.

Instead, respondent concluded that petitioner's management, had it been prudent, would have recognized in 1979-1980 the difficulties and potential expense associated with the production nuclear plants, and "sought to limit its risk by selling all or part of its share off-system. * * * NOPSI could then have purchased less expensive coal-fired capacity to meet its future needs." J.A. 25. Respondent reasoned that "NOPSI could have stood by its commitment to take and pay for Grand Gulf I power as required by the System and ultimately determined by the FERC, but should have reduced its risks by making power sales of that portion of its commitment which

exceeded a 9 percent share of Grand Gulf."[8] Respondent emphasized that the resulting reduction in costs would follow "from an offset to such costs and not from a rejection of the FERC's allocation of them." *Id.* at 25. See Pet. App. 8A-9A, 24A.

Because respondent's decision (unlike the order of the Mississippi Supreme Court at issue in *Mississippi Power*) questions the prudence neither of the allocation of Grand Gulf power within the MSU system nor of the wholesale rate set by FERC, the *Mississippi Power* decision is not plainly dispositive.[9] Indeed, had respondent found that petitioner were *now* in fact able to sell expensive Grand Gulf power off-system and replace it with cheaper power obtained elsewhere, it plainly would have been consistent with *Mississippi Power* and *Nantahala* for respondent to have held that a failure to do so was imprudent. While it may no longer be possible for petitioner to engage in

[8] Petitioner (Br. 14, 37) and the Solicitor General (Br. 18 n.8) take issue with the eight percent disallowance. But the number was not selected randomly. While respondent suggested that petitioner might reasonably have disposed of all of its Grand Gulf power, it was willing to assume, "based on expert testimony in the record," that petitioner could prudently "have retained a portion of Grand Gulf I relative to its comparative size within the MSU system –that is, about 9 percent of the system's Grand Gulf I obligation." J.A. 25. Because petitioner is obligated to accept 17% of Grand Gulf I's output, respondent found the eight percent disallowance appropriate.

[9] Petitioner asserts that it could not have been held imprudent "for failing to avoid its Grand Gulf allocation unless the allocation was itself unreasonable" (Br. 36). But that is not so: the conclusion that petitioner should have cushioned its risk by arranging to sell some Grand Gulf power off-system says nothing about the reasonableness of the allocation between MSU system participants. Petitioner also reads *Mississippi Power* and *Nantahala* for the proposition that States may not base prudence determinations on steps that utilities should have taken to reduce costs in the past (Br. 37 n.43). The cited pages of those opinions, however, indicate only that "States may not alter FERC-ordered allocations of power by substituting their own determinations of what would be just and fair." *Mississippi Power*, 108 S.Ct. at 2438. See *Nantahala*, 476 U.S. at 955.

such a transaction, the question here is whether respondent may find petitioner's failure to do so *in 1979-1980*—when it may well have been possible[10]—to have been imprudent. That question is not addressed in *Mississippi Power*. And however the courts ultimately answer it, the answer should not come in an offhand manner during the course of a federal court's abstention analysis.

C. The Court Should Not Create A Special Exception To *Younger* For Preemption Claims

Petitioner also argues for something that amounts to an entirely new exception to *Younger*: it contends that abstention is inappropriate whenever the federal claim is one of preemption (Br. 32-34). Petitioner's reasoning, as we understand it, is that a preemptive federal law would deny jurisdiction over the subject matter to a state administrative tribunal, thus depriving the State of any legitimate interest in conducting the pending proceeding (Br. 32). Any such contention, however, is squarely foreclosed by this Court's precedents. *Dayton Christian Schools*, upon which petitioner relies, is in fact one of the cases in which the Court has "repeatedly rejected the argument that a constitutional attack on state procedures themselves 'automatically vitiates the adequacy of those procedures for purposes of the *Younger-Huffman* line of cases.'" 477 U.S. at 628 (quoting *Moore*, 442 U.S. at

[10] Petitioner appears to suggest a finding by "the lower courts" that such a transaction would not have been possible in 1979-1980 (Br. 37). While the district court expressed skepticism on the point, it plainly made no such finding, and in fact noted that petitioner's president had testified in 1980 that petitioner could sell Grand Gulf power off-system (see Pet. App. 30A & n.11); for its part, the court of appeals did not address the factual issue at all. This issue should, of course, be resolved in petitioner's pending state court lawsuit challenging respondent's order as, among other things, based on clearly erroneous findings of fact. Needless to say, the pendency of a state suit involving factual claims that are related to and could obviate the federal issues, particularly constitutional issues like preemption, counsels restraint by the federal courts.

427 n.10). See 17A C. Wright, A. Miller & E. Cooper, *Federal Practice & Procedure* § 4255 at 259 (1988).

In any event, petitioner is incorrect in asserting that respondent lacks either jurisdiction over or an interest in the rate proceedings.[11] The proceeding in this case was initiated to settle intrastate retail rates, a matter that is squarely within respondent's jurisdiction. In the course of that—or any—rate proceeding, respondent was obligated to determine which cost factors had to be disregarded as a matter of federal law. Indeed, as the court of appeals explained, the filed rate doctrine was developed for precisely that reason, "to ensure the supremacy of FERC's orders in state as well as federal proceedings." Pet. App. 14A. If respondent errs in its interpretation of its FERC-imposed obligations, that mistake, like any other error of federal statutory or constitutional law, may be remedied on appeal to the state courts. See *Nantahala*, 476 U.S. at 964-966 (citing cases in which state courts applied the filed rate doctrine to set aside the decisions of state utility commissions).

Abstention thus does not amount to a decision on the merits, as petitioner argues (see Pet. Br. 32), when the federal claim is one of preemption. Petitioner evidently intends to suggest that a federal court may abstain only when the State has an important interest in the proceeding, that the State's interest cannot be important if the preemption claim is valid, and that a decision to abstain therefore necessarily implies a finding that the preemption claim is insubstantial. We note that this analysis hardly serves to distinguish preemption from other fed-

[11] While petitioner puts its argument in terms of jurisdiction, this is not a case like, for example, one involving the Double Jeopardy Clause (compare *Abney v. United States*, 431 U.S. 651 (1977)), where simply subjecting a party to a particular proceeding denies that party its federal rights. Here, respondent has undoubted authority to subject petitioner to a proceeding designed to set intrastate rates. Petitioner's real complaint is with the merits of respondent's rate order.

eral constitutional claims; under petitioner's analysis, the State does not have a legitimate interest in, for example, enforcing nuisance regulations that are asserted to violate the First Amendment (as was alleged in *Huffman*), although abstention nevertheless repeatedly has been held proper in the face of such claims. But petitioner's argument misses a broader point. The State's underlying interest (here, setting retail rates; in *Huffman*, regulating nuisances) remains legitimate and substantial; if petitioner is correct on the merits of its preemption argument, respondent simply made an error in its effectuation of that interest. Indeed, under petitioner's analysis, it is the decision *not* to abstain that requires resolution of the merits, for the State is deprived of its interest in the proceeding only if its action is preempted. A decision *to* abstain does not require any consideration of the merits; the federal court need find only that the federal claim may be presented to a competent state court.

In fact, there is nothing magic in a claim of preemption —which is, of course, a Supremacy Clause claim that is grounded on the asserted inconsistency of state action with a federal statute—that distinguishes such a claim from other constitutional claims for abstention purposes. Cf. *Lake Carriers' Ass'n v. MacMullan*, 406 U.S. 498, 510-512 (1972) (*Pullman* abstention warranted in the face of a preemption claim). Surely there is no reason to presume that state judges, who are bound by Article VI of the Constitution to enforce federal statutes, will be less willing to vindicate federal statutory than federal constitutional rights. See generally *Huffman*, 420 U.S. at 611. Surely federal statutory rights are not more "important" in comity terms to the federal Government than are rights created directly by the federal Constitution. And surely the federal interest in the effectuation of federal constitutional rights—an interest that is reflected not only in th Constitution itself but also in Congress's enactment of 42 U.S.C. § 1983—is no weaker than its interest in the vindication of statutorily created

programmatic concerns.[12] A special rule for preemption cases accordingly is unnecessary.

D. The Solicitor General's Arguments Do Not Justify A Refusal To Abstain Under *Younger*

The Solicitor General's *Younger* arguments are noteworthy principally because they fail to overlap at even a single point with petitioner's analysis. While the Solicitor General must get credit for creativity and candor, we believe that his arguments are ultimately inconsistent with this Court's precedents.

The Solicitor General initially contends that the notions of comity underlying *Younger* are due little respect in this case; pointing to petitioner's participation with other utilities in a multi-state common pool, the Solicitor General suggests that "the interests of several states are at odds" in this "inherently interstate dispute" (Br. 21). Despite the Solicitor General's disclaimer (*ibid.*), we note that this analysis makes sense only on the assumption that state courts cannot be trusted to recognize the legitimate interests of sister States, a proposition that surely " 'reflect[s] negatively upon the state court's ability to enforce constitutional principles.' " *Huffman*, 420 U.S. at 604.[13] But however that may be, the short

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[12] The Solicitor General suggests (Br. 22) that certain preemption claims may be unsuitable for resolution by the state courts because they turn on an understanding "of a complex federal regulatory scheme." But even granting the dubious proposition that statutory claims are more difficult than constitutional ones, there is no reason to suppose that the federal courts have an expertise superior to that of the state courts in resolving claims under the Federal Power Act in general and the filed rate doctrine in particular. Indeed, the state courts, which routinely review challenges to the orders of state utility commissions (see page 8, *supra*), may well be the superior fora for the resolution of such claims. The district judge below was himself "confident that Louisiana's state courts are more than competent to handle any federal question presented." Pet. App. 27A.

[13] Indeed, the regulatory interest in *Burford* itself was strikingly similar to that in this case: the rights to oil at issue there were developed by the Texas Railroad Commission "in cooperation with

answer to the Solicitor General's argument is that this is *not* an interstate dispute. Respondent disturbed neither FERC's allocation of Grand Gulf power within the MSU system nor the interstate wholesale rates to be paid by petitioner; respondent's administrative proceeding concerned only intrastate retail rates, and addressed the simple question whether certain of petitioner's costs would be absorbed by petitioner rather than by its instate retail customers. This is a wholly intrastate question that has no conceivable bearing on the interests of other States—a conclusion that is borne out by the failure of any of the purportedly affected States to file in opposition to respondent.[14]

The Solicitor General also suggests that the nature of the proceeding here makes *Younger* abstention inappropriate, noting that petitioner sought declaratory relief rather than an injunction against the pending state ju-

other oil producing States" as part of the Interstate Oil Compact Commission. 319 U.S. at 320-321 & n.12.

[14] The Solicitor General more ambitiously offers a multi-part balancing test from which he derives the conclusion that abstention is improper here because (1) the federal claim would be dispositive of the merits of the lawsuit; (2) there are no unresolved threshold issues of state law; and (3) there are "multi-state interests" in this case (Br. 22-23). But the first and second of these factors were present in many of this Court's decisions under *Younger*. See, *e.g.*, *Dayton Christian Schools*; *Middlesex County Ethics Comm.*; *Juidice*; *Huffman*. And as we explain in text, the third factor, even if relevant, is simply not present in this case. The Solicitor General also notes that parties may no longer appeal to this Court from state courts as a matter of right when state statutes are upheld against constitutional attack (Br. 22 n.15). See Act of June 27, 1988, Pub. L. No. 100-532, §§ 1, 7, 102 Stat. 662, 664. The Court has made it clear, however, that the existence of such a right is not an essential element of *Younger* abstention: "quite apart from appellee's right to appeal [to this Court] had it remained in state court, we conclude that it should not be permitted the luxury of federal litigation of issues presented by ongoing state proceedings, a luxury which, as we have already explained, is quite costly in terms of the interests which *Younger* seeks to protect." *Huffman*, 420 U.S. at 605-606.

dicial proceedings; "[t]he sole impact of the federal court's ruling would be its res judicata effect" which, the Solicitor General states, "is not in itself enough to warrant abstention" (Br. 25). In fact, however, this Court has made it clear that abstention is in order when the party seeking federal relief requests a declaratory judgment, since "the declaratory relief alone has practically the same practical impact as a formal injunction would." *Samuels v. Mackell*, 401 U.S. 66, 72 (1971).[15] See *Deakins v. Monaghan*, 108 S.Ct. 523, 533 (1988) (White, J., concurring). See also Shapiro, *Jurisdiction and Discretion*, 60 N.Y.U.L.Rev. 543, 582 (1985) (footnote omitted) ("questions of federalism arise in contexts other than a prayer for a federal court injunction against a state proceeding. Such questions are also raised, for example, by the existence of parallel state and noninjunctive federal proceedings").

In a related vein, the Solicitor General suggests that petitioner "should not be deemed to have triggered *Younger* abstention" by filing a suit for review of respondent's order in state court (Br. 26). Whether and when petitioner chose to file its state suit, however—and

[15] " 'Is the declaration contemplated here to be *res judicata*, so that the [state court] cannot hear evidence and decide any matter for itself? If so, the federal court has virtually lifted the case out of the State [court] before it could be heard. If not, the federal judgment serves no useful purpose as a final determination of rights.' " *Samuels*, 401 U.S. at 72 (quoting *Public Service Comm'n* v. *Wycoff Co.*, 344 U.S. 237, 247 (1952)). The Solicitor General contends (Br. 25) that requiring abstention in cases seeking declaratory relief would make abstention mandatory whenever parallel proceedings are pending in state and federal court. In fact, however—as the Solicitor General implicitly acknowledges (Br. 25 n.20)—the limiting principle adopted by the Court involves not the type of relief sought but the importance of the state interest at issue. See *Pennzoil*, 481 U.S. at 14 n.12. We also note that petitioner did seek to enjoin respondent's order, a request that, if granted, would have pretermitted the state court's consideration of the right to interim relief—an important part of the ongoing state proceeding. Cf. *id.* at 14. See also *Alabama Public Service Comm'n v. Southern Ry. Co.*, 341 U.S. 341, 349 (1951).

the nature of any other pending suits (see Br. 25-26)[16] —is simply irrelevant here. A party that takes issue with a state trial court (or, as in this case, administrative) determination may not simply decide to forgo the use of state appellate procedures: "a necessary concomitant of *Younger* is that a party in [petitioner's] posture must exhaust his state appellate remedies before seeking relief in the District Court." *Huffman*, 420 U.S. at 608. Petitioner "had available the remedy of appeal" in state court, and that is enough to make *Younger* abstention appropriate. *Id.* at 610. See also *Pennzoil*, 481 U.S. at 14 n.13, 15; *Moore*, 442 U.S. at 425; *Juidice*, 430 U.S. at 337.

II. *BURFORD* ABSTENTION IS PROPER IN THIS CASE

Burford abstention is appropriate "in situations in which the exercise of jurisdiction by a federal court would disrupt a state administrative process." *Zwickler v. Koota*, 389 U.S. 241, 256 (1967) (Harlan, J., concurring in the judgment). See *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 814 (1976). Petitioner is incorrect in asserting (Br. 22, 23) that the existence of an unsettled issue of state law is a prerequisite to *Burford* abstention; it is interference with state processes of regulation and with the formulation of state regulatory policy that is central.[17] The point was

[16] The Solicitor General suggests (Br. 25-26) that none of the pending state judicial proceedings implicates important state interests. As we explain above, however, ratemaking is a vital state concern, and the State has a compelling interest in seeing its courts perform what the district court described as their function of "assessing and formulating state policy" with regard to utilities (Pet. App. 27A).

[17] Quoting from *Colorado River*, petitioner states that *Burford* abstention is proper only when a case involves difficult questions of state law *and* federal review would disrupt the development of coherent state policy (Br. 22). Quoting virtually identical language from the same opinion, the Solicitor General states that abstention is proper under *Burford* when the case involves difficult questions of state law *or* federal review would disrupt the development of coherent state policy (Br. 16). The Solicitor General's reading of *Colorado River* is correct. See 424 U.S. at 814 (emphasis added) ("*it is enough* that exercise of federal review of the question in a case and in similar cases would be disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern").

settled in *Alabama Public Service Comm'n v. Southern Ry. Co.*, 341 U.S. 341 (1951), which involved a challenge to a regulatory decision of the state public service commission. This Court acknowledged that there were no unsettled issues of state law in the case (*id.* at 344 & n.5; see P. Bator, D. Meltzer, P. Mishkin & D. Shapiro, *Hart & Wechsler's The Federal Courts & The Federal System* 1365 (3d ed. 1988)), and the only ground on which the order was challenged in federal court was its asserted inconsistency with the Due Process Clause of the federal Constitution. See 341 U.S. at 346-347; 91 F.Supp. 980, 986-987, 995. The Court nevertheless held abstention appropriate "'so as to avoid needless obstruction of the domestic policy of the states'" (341 U.S. at 351 (citation and footnote omitted))—a holding that was vigorously criticized by Justice Frankfurter on the ground that the issues in the case were entirely federal. See 341 U.S. at 355, 359-362 (Frankfurter, J., concurring in the result). Indeed, Justice Frankfurter read *Alabama Public Service Comm'n* as effectively holding that "hereafter no federal court should entertain a suit against any action of a state agency" so long as judicial review is available in the state courts. *Id.* at 362 (Frankfurter, J., concurring in the result).[18]

[18] The Solicitor General suggests (Br. 19) that *Alabama Public Service Comm'n* is inapplicable here because the federal Government had no regulatory role in that case—which involved the regulation of intrastate rail service—comparable to the one played here by FERC. But the authority of the Interstate Commerce Commission under the scheme at issue in *Alabama Public Service Comm'n* was strikingly similar to FERC's authority in administering the Federal Power Act. See 341 U.S. at 345-346. And the authority of the States to regulate intrastate power rates under the Federal Power Act is every bit as great as their authority over intrastate transportation. See page 10, *supra*.

This case falls squarely within the rule of *Alabama Public Service Comm'n*. Almost by definition, federal involvement at this stage of the proceeding would disrupt state administrative processes by precluding consideration of the case by the state courts—which, with respondent, share responsibility for "assessing and formulating state policy" (Pet. App. 27A). Indeed, intrastate ratemaking proceedings present "the quintessential *Burford* setting." *Aluminum Co. of America v. Utilities Comm'n*, 713 F.2d 1024, 1029 (4th Cir. 1983), cert. denied, 465 U.S. 1052 (1984). Choosing "among rate structures involves difficult and important questions of economic supply and distributional fairness" (*Central Hudson*, 447 U.S. at 569); it is difficult to disagree with the court of appeals' recognition at an earlier stage of this proceeding that, "[a]s with the regulatory scheme at issue in *Burford*, the regulation and adjustment of local utility rates is of paramount local concern and a matter which demands local administrative expertise." *NOPSI v. City of New Orleans*, 798 F.2d 858, 862 (5th Cir. 1986), cert. denied, 481 U.S. 1023 (1987).

The Solicitor General suggests (Br. 18-19) that the problem here is not a predominantly local one. But the regulation of intrastate rates, as well as the considerations that dictated respondent's order (the behavior of petitioner's management in 1979-1980 (see J.A. 24-25)), is entirely local in character. The related argument that resolution of the preemption claim will not require the consideration of "'local factors'" (Br. 18 (quoting *Alabama Public Service Comm'n*, 341 U.S. at 349)) assumes that answering the federal question here will be a simple matter of looking within the four corners of FERC's opinion. In fact, however, petitioner's argument on the merits raises a range of difficult questions—whether, for example, a prudence disallowance must be premised on savings that were possible in the marketplace (see, *e.g.*, Pet. App. 31A n.11)—that in turn may require analysis both of the state law on prudence and of the factual record. These questions should be answered by a court

that is sensitive to local concerns.[19] "As adequate state court review of an administrative order based upon predominantly local factors is available to [petitioner], intervention of a federal court is not necessary for the protection of federal rights." *Alabama Public Service Comm'n*, 341 U.S. at 349 (footnote omitted).[20]

In response to these points, petitioner argues principally that this Court "has repeatedly held *Burford* abstention improper" when the challenge to a state regulatory decision "raises only federal claims" (Br. 23). The cases that petitioner cites for this proposition—which is,

[19] The Solicitor General also maintains (Br. 17) that any disruption to state policy from a finding of preemption would follow from the congressional allocation of regulatory power. But this argument confuses the merits with the abstention question. Certainly, if the Council ultimately is found to have exceeded its regulatory authority, that holding will rest on congressional action—just as a ruling against the regulator in *Alabama Public Service Comm'n* would have turned on the meaning of the Due Process Clause. It is the consideration and decision of the issue by a court that is unfamiliar with local considerations that threatens disruption to the state administrative scheme.

[20] Petitioner (Br. 26 n.28) and the Solicitor General (Br. 19 n.10) argue that the state courts here cannot be viewed as part of the regulatory process because review of intrastate rate orders is not concentrated in a single Louisiana court. But whether or not concentrated, the nature of the administrative review here is identical to that characterized as "an integral part of the regulatory process" under state law in *Alabama Public Service Comm'n* (341 U.S. at 348). See 17A C. Wright, A. Miller & E. Cooper, *supra*, § 4244 at 83 (labeling "too narrow" the assertion that *Burford* abstention is proper only when administrative review takes place in a specialized court). In any event, the intensely local nature of the process of review is in fact emphasized by the Louisiana scheme. While orders of the Louisiana Public Service Commission, which regulates most state utilities, are reviewable by a state district court sitting in Baton Rouge (see La. Rev. Stat. Ann. ch. 45, § 1192 (West 1982)), the Commission has no jurisdiction over utilities that, like petitioner, are regulated by the governing authority of a political subdivision. La. Const. art. 4, § 21(C) (West 1977). Review of respondent's rate orders is accordingly conducted by local courts that are, in contrast with courts sitting in Baton Rouge, especially familiar with local conditions.

in any event, inconsistent with *Alabama Public Service Comm'n*—do not support it. The Court's decision in *Public Utilities Comm'n v. United Fuel Gas Co.*, 317 U.S. 456 (1943), upon which petitioner heavily relies (Br. 24), was rendered prior to the reargument and decision in *Burford*, and therefore could hardly have contained even an implicit holding that *Burford* abstention was inapplicable in a challenge to the regulatory proceeding involved.[21] The Court's refusal to abstain in *McNeese v. Board of Education*, 373 U.S. 668 (1963) (cited at Pet. Br. 23), was motivated at least in part by doubts that the state administrative remedy was adequate to effectuate federal rights. See 373 U.S. at 674-676. In addition, *McNeese* involved a claim of racial discrimination brought under 42 U.S.C. § 1983, for which use of a federal forum was deemed particularly appropriate. See 373 U.S. at 671-673. *Public Utilities Comm'n v. United*

[21] Indeed, Justice Black, the author of the Court's opinion in *Burford*, vigorously dissented in *United Fuel* (see 317 U.S. at 470); the author of the Court's opinion in *United Fuel*, Justice Frankfurter, issued a vigorous dissent in *Burford* (see 319 U.S. at 336). Justice Frankfurter offered an equally vigorous separate opinion in *Alabama Public Service Comm'n*, suggesting that the Court there departed from prior practice by ordering abstention in a case that involved only issues of federal law. See 341 U.S. at 355-356, 362 (Frankfurter, J., concurring in the result). This strongly suggests that the limitations on abstention that petitioner draws from *United Fuel*, even if present in the case, are no longer good law. In any event, the preemption claim in *United Fuel* was not, as petitioner maintains (Br. 24), identical to the one in this case. While the investigation there was commenced in the context of a retail ratemaking, it involved the utility commission's *explicit* assertion of jurisdiction over wholesale interstate rates. See 317 U.S. at 458, 461, 465. Here, of course, respondent has made no such assertion. In addition, the Court's decision in *United Fuel* to resolve an issue of local law was motivated in large part by its conclusion that the litigation—which had been commenced in district court in 1935 and not resolved by that court until 1942—"has already been in the federal courts an inordinately long time," so that "considerations of equity require that the litigation be brought to an end as quickly as possible." *Id.* at 463; see *id.* at 460-461 & n.2.

States, 355 U.S. 534 (1958), upon which petitioner also relies (Br. 24), does not discuss *Burford* abstention. In any event, the case involved an action by the United States brought in anticipation of a state enforcement proceeding (see 355 U.S. at 536-539), in a setting in which the state agency might not have entertained the federal claim (see *id.* at 539-540).

Finally, petitioner (Br. 25-26) and the Solicitor General (Br. 17, 18-19) repeat their contentions that abstention is inappropriate in cases where preemption is asserted. Again, we fail to see why state courts should be presumed competent to resolve federal constitutional, but not statutory, claims. In any event, petitioner and the Solicitor General fail to recognize that every preemption claim involves not only a federal interest that is said to have a preemptive effect, but also a state interest that is said to be preempted. That state interest gives the state courts both a familiarity with the issues and a concern for reaching the proper outcome that is every bit as great as that of the federal courts.

The flip sides of the preemption inquiry are plainly visible here. The Federal Power Act was enacted both to grant the federal Government authority to regulate the interstate sale of power and to exclude the federal Government from the regulation of intrastate sales: "it could not be plainer that the statutes at issue were designed to confine the scope of FERC's jurisdiction by prohibiting FERC from regulating matters within the sphere of authority States had to regulate retail utilities under our old Commerce Clause cases." *Mississippi Power*, 108 S.Ct. at 2447 (Brennan, J., dissenting). See generally *Interstate Natural Gas Co.*, 331 U.S. at 690; *Connecticut Light & Power*, 324 U.S. at 525. The state interests are thus manifest in the federal statute itself. In such circumstances, the federal courts should not prevent the state courts from completing the normal administrative process.

III. THE COURTS BELOW SHOULD NOT SUBSTITUTE THEIR JUDGMENT FOR THAT OF THE STATE COURTS IN DETERMINING THE AVAILABILITY OF PRELIMINARY RELIEF

In a final attempt to embroil the federal courts in this dispute, petitioner (Br. 38-39) and the Solicitor General (Br. 27-30) argue that, even if abstention is otherwise appropriate, the district court should have determined the availability of preliminary injunctive relief. But nothing in this Court's decisions supports the creation of such a hybrid action, in which the preliminary litigation would proceed in one forum while the litigation proceeding toward the final judgment on the merits would move forward in another.[22]

To the contrary, the Court's disposition of the federal claims in *Doran v. Salem Inn, Inc.*, 422 U.S. 922 (1975), suggests that a special exception to the abstention rules should not be created for preliminary relief. In *Doran*, three operators of bars (Salem, Tim-Rob, and M & L) brought suit in federal court to challenge the constitutionality of a ban on topless dancing, seeking a temporary restraining order, preliminary injunctive relief, and a declaratory judgment. See *id.* at 924-925. Because there were no pending state proceedings involving Salem and Tim-Rob, this Court held that the district court had properly declined to abstain in their actions; the Court went on to affirm the district court's award of preliminary injunctive relief to Salem and Tim-Rob because the bars faced the prospect of irreparable injury in the form of

[22] The decisions cited by petitioner and the Solicitor General stand for no such proposition. *Babbitt v. United Farm Workers*, 442 U.S. 289, 312 n.18 (1979) (cited at Pet. Br. 39 and U.S. Br. 29), and, evidently, *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 140 n.3 (1970) (cited at U.S. Br. 29 & n.26), involved a form of *Pullman* abstention; there were, in those cases, no pending state proceedings to which the federal courts could defer. *Leiter Minerals, Inc. v. United States*, 352 U.S. 220 (1957) (cited at U.S. Br. 29), was not an abstention case at all; it involved the interpretation of 28 U.S.C. § 2283 and turned on the special status of the United States as a litigant. See 352 U.S. at 225-226.

"a substantial loss of business and perhaps even bankruptcy." *Id.* at 932. But M & L stood in a different position, having been served with criminal summonses in state court while its federal action was still "in an embryonic stage." Although M & L presumably faced the same irreparable injury as the other operators, the Court held that the pendency of the state proceedings meant that "M & L's prayer for injunction is squarely governed by *Younger*." *Id.* at 929.

This conclusion followed directly from the principles that underlie the *Younger* doctrine. *Younger* presumes that state courts are willing and able to enforce federal rights. And if state courts are permitted to settle the existence of a party's federal rights for all time (subject to review in this Court[23]) by issuing a final judgment on the merits, surely they may be trusted to decide questions of interim relief. Indeed, a federal court's substitution of its judgment for that of a state court about the availability of preliminary relief reflects just as "negatively upon the state court's ability to enforce constitutional principles" (*Juidice*, 430 U.S. at 336 (citations and internal quotation marks omitted)) as would a federal court's decision on the merits. So long as state court procedures make provision for the award of preliminary relief, principles of comity preclude the involvement of federal courts.

The same conclusion is appropriate under *Burford*. In *Alabama Public Service Comm'n* the Court squarely rejected the proposition that a federal court should take jurisdiction "whenever a plaintiff can show irreparable loss caused by an allegedly invalid state administrative order ripe for individual review in the state courts." 341 U.S. at 344-345. The Court therefore held federal inter-

[23] Despite the Solicitor General's hint to the contrary (Br. 28 n.24), interim relief is available from this Court in cases pending in state court when that is necessary to protect federal rights. See, *e.g.*, *American Trucking Ass'n v. Gray*, 108 S.Ct. 2 (1987) (opinion of Blackmun, J.).

vention inappropriate in the absence of a showing that the "state procedure for review of Commission orders is in any way inadequate to preserve for ultimate review in this Court any federal questions arising out of such orders." *Id.* at 349 (footnote omitted). That reasoning is fully applicable here.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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No. 88-348

IN THE
Supreme Court of the United States
October Term, 1987

NEW ORLEANS PUBLIC SERVICE INC.,
Petitioner,

v.

THE COUNCIL OF THE CITY OF NEW ORLEANS, *ET AL.*,
Respondents.

On Writ of Certiorari To The United States Court of Appeals for the Fifth Circuit

BRIEF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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Fifth Circuit

**BRIEF OF THE NATIONAL ASSOCIATION
OF REGULATORY UTILITY COMMISSIONERS
AS AMICUS CURIAE
IN SUPPORT OF RESPONDENTS**

INTEREST OF AMICUS CURIAE

The National Association of Regulatory Utility Commissioners (NARUC) submits this brief as amicus curiae urging affirmance

due to the substantial harm reversal of the decision below may have upon the regulation of public utilities by its member State regulatory commissions. The NARUC files this brief with the written consent of the Petitioner and the Respondents.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within its membership are the governmental bodies of the fifty States, and the governmental agencies of the District of Columbia, Puerto Rico, and the Virgin Islands engaged in the regulation of utilities and carriers. The Council of the City of New Orleans, Respondent herein, is an Associate Member of the NARUC. The mission of the NARUC is to serve the public interest by seeking to improve the quality and effectiveness of public regulation in America.

More specifically, the NARUC contains State and local officials charged with the

duty of regulating natural gas, electric and communications utility companies operating within their respective jurisdictions. As such, these officials have the obligation to assure the establishment and operation of utility companies which serve the public interest. This means that State and local regulators must, under law, seek to ensure that dependable and safe utility service is provided consumers at rates which are just, reasonable and nondiscriminatory.

In the decision herein under review, the United States Court of Appeals for the Fifth Circuit held that the United States District Court, Eastern District of Louisiana, had not abused its discretion in abstaining from deciding Petitioner's claim that the Council of the City of New Orleans' decision fixing the retail rates it may charge its customers was preempted by an earlier decision of the Federal

Energy Regulatory Commission.[1] Petitioner New Orleans Public Service Inc. (NOPSI), a utility selling electricity to retail consumers in the City of New Orleans, has appealed the Fifth Circuit's decision to this Court on the ground that the District Court may not refuse to adjudicate its preemption claim, despite the fact that the State of Louisiana maintains a regulatory and judicial system capable of hearing and deciding all of its claims--Federal as well as State. Specifically, NOPSI argues that once the Federal Energy Regulatory Commission (FERC) had issued a ratemaking order applicable to the wholesale sale or allocation of electricity, the Federal courts cannot refuse to hear the utility's

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[1] The decision of the Fifth Circuit appears at Appendix 1A of the Petition for Writ of Ceriorari. This decision has been reported at 850 F.2d 1069. The decision of the District Court, which is unreported, appears at Appendix 21A of the Petition for Writ of Ceritiorari. Subsequent reference will be made to these decisions as they appear therein in this form: App. at ___.

allegations that State or local commission treatment of that wholesale rate in a subsequent retail rate proceeding is preempted.

If adopted by this Court, Petitioner's argument would substantially disrupt the systems of regulation and judical review in an area of State concern recognized as vital is past decisions of the Supreme Court: State regulation of the retail rates and services of public utilities. Under the Constitution, the State courts are fully capable of reviewing the decisions of State and local regulatory bodies, including any issues of preemption which might be raised therein. Petitioner, however, would have this Court endorse an alternative avenue of judicial review which could enable utilities such as NOPSI to invoke the jurisdiction of the Federal District Courts in frequent, potentially piecemeal litigation involving issues at

the heart of the retail ratemaking process. Current ratemaking practices, however, depend upon the maintenance of regularized judicial review procedures in which retail ratemaking decisions are considered in whole by State courts with a right of final appeal to this Court. The NARUC's interest in addressing the impact of Petitioner's arguments on the practices and procedures of its member commissions is strong, compelling its participation in this case.

SUMMARY OF ARGUMENT

By its actions throughout the proceedings which have resulted in this case coming to this Court, NOPSI has sought to legitimize a system for the judicial review of local and State regulatory decisions which would enable any utility--be it electric, communications or natural gas--to have its choice of a State or Federal forum in which to make its case.

Rather than pursue its available remedies in the courts of the State of Louisiana, NOPSI has sought Federal court intervention in its dispute with the Council of the City of New Orleans (the Council) over the rates it may lawfully charge its customers for the retail sale of electricity. NOPSI claims, of course, that its reliance on the preemptive value of this Court's decision in Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S.____, 101 L.Ed2d 322 (1988) precludes a Federal District Court from invoking the equitable doctrine of abstention to refuse to decide the federal issues raised in the company's complaint.

The NARUC respectfully submits that the District Court, as affirmed by the Court of Appeals, properly refused to afford utilities like NOPSI their preferred Federal forum to resolve issues of essentially local impact. Contrary to

NOPSI's assertions, the issues involved in this case implicate substantial State interests which a reversal of the Court of Appeals' decision would harm substantially. We wish to make two points in this regard: first, that the abstention doctrines developed by this Court over the last forty years recognize and affirm the fact that we enjoy a governmental system based upon "Our Federalism", and that therefore, the Federal Courts must not unduly interfere with the activities of the States, particularly where, as here, such interference would occur in an area involving complex regulatory programs lying at the core of the State's exercise of its police powers to protect its citizenry.

Second, as this Court quite recently recognized, regulation of electric utilities is on the cusp of major, perhaps revolutionary, change. Duquesne Light Co. v. Barasch, 488 U.S.___, 102 L. Ed.2d 646,

662 n. 10 (1989). The "emergent market for wholesale electric energy" described in Duquesne Light can only be expected to render the complexities of State regulation of retail service even more complex. Inevitably, the next few years will witness substantial State commission experimentation with new policies and procedures (e.g. competitive bidding for the acquisition of new generating capacity) which will not readily suffer the interference of Federal court review of "federal issues" which are inextricably bound up in emerging State resource acquisition policies. The Court's decision in Duquesne Light recognizes and affirms the need for regulatory flexibility in the development of ratemaking methodologies, which in all likelihood will implicate "federal issues"of the sort raised by NOPSI, free from prescription or prohibition by the Federal courts. Through

its analysis of the principles of abstention, the Court of Appeals properly affirmed the policies of noninterference enshrined in "Our Federalism" and therefore, should be affirmed.

ARGUMENT

In the decision before the Court, the Fifth Circuit found no abuse of discretion in the District Court's decision to abstain from excercising jurisdiction over NOPSI's claim that the Council's decision to disallow the recovery of certain costs in retail rates on the grounds of the utility's imprudence was preempted. App. at 20A. Relying upon both Burford[2] and Younger[3] abstention, the Court of Appeals held that the District Court could properly find that the exercise of Federal court

[2]Burford v. Sun Oil Co., 319 U.S. 315 (1943).

[3]Younger v. Harris, 401 U.S. 37 (1971).

jurisdiction "would interfere with the state regulatory system" (App. at 17A), and further, that NOPSI "had an adequate opportunity to litigate its federal claims" in ongoing judicial proceedings in State court (App. at 18A), and that therefore, abstention was not an abuse of discretion.

In its brief to this Court, NOPSI argues that neither Burford or Younger provides a proper basis for the Fifth Circuit's affirmance of the District Court's ruling.[4] While acknowledging that its claim of preemption under the Federal Power Act, 16 U.S.C. sec. 824 et seq. (1982), is now pending in State court (NOPSI Br. at 15), NOPSI asserts that it is entitled to a Federal forum to litigate this claim because, inter alia, there are no important State interests implicated in this litigation. NOPSI Br. at 20-21. In

[4]Reference to the NOPSI Brief will be in this form: "NOPSI Br. at ___".

its brief on the merits, the Council has shown that the Fifth Circuit's ruling on the law of abstention is correct, and should not be reversed. Herein, the NARUC disputes the utility's claim that there are no important or legitimate State interests at stake in this case, and further, seeks to provide some insight on the disruptive effect Federal court intervention will have on State regulation of the retail rates and services of electric utilities.

THE COUNCIL'S REGULATION OF NOPSI'S RETAIL RATE LEVELS, INCLUDING ITS TREATMENT OF THE UTILITY'S PRUDENCE, ENCOMPASS IMPORTANT STATE AND LOCAL INTERESTS

As this Court has recently acknowledged, "the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States." Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375, 377 (1983). This Term, the Court has

reaffirmed the constitutional principle that in discharging this important function, the States have broad authority to "decide what rate-setting methodology best meets their needs in balancing the interests of the utility and the public." Duquesne Light, supra, 488 U.S. at ___, 102 L. Ed.2d at 663. Therein, the Court observed that retail ratemaking is a difficult undertaking, requiring the consideration of a multitude of factors: "The economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result." Id., 102 L. Ed. 2d at 646.

In addition, in a recent decision relied upon heavily by NOPSI, the Court has stated that even in cases in which State and local commissions are reviewing the passthrough of wholesale purchased power costs approved by the FERC, the "economic judgments" that these commissions are

entitled to make may well include the reasonableness of the "quantity of power procured from a particular source. . .if lower-cost power is available elsewhere, even though the higher-cost power actually purchased is obtained at a FERC-approved, and therefore reasonable, price." Nantahala Power and Light Co. v. Thornburg, 476 U.S. 953, 972 (1986) (Emphasis in original). In Mississippi Power & Light, supra, (MP&L), the decision upon which NOPSI bases much of its case, the Court again acknowledged that State jurisdiction to review the reasonableness of a utility's power purchases would not necessarily be preempted "if [the utility] had the legal right to refuse to buy that power." 487 U.S. at ___, 101 L. Ed.2d at 340.

The issue underlying the Council's review of NOPSI's retail rates is not whether the utility had the right to refuse to buy power generated by the Grand Gulf

plant, but rather, what responsibility the company had to deal with the growing risks of the project at the time options were available to reduce those risks. App. at 9A, 13A. Relying on MP&L, NOPSI asserts that the Council is unquestionably foreclosed from determining this question, and that the Fifth Circuit's finding that the resolution of this issue is not consigned to "federal exclusivity" (App. at 14A) is erroneous. NOPSI Br. at 21-22. While acknowledging the availability of State court review of the Council's resolution of this issue with final review in this Court, NOPSI claims that its "federal rights" can only be vindicated through the equitable powers of the lower Federal courts. Id. at 21.

Contrary to NOPSI's assertions, the case does involve important State interests

of the sort considered crucial in Burford[5] and Younger[6]. As described supra at 12-14, this Court has never doubted the importance

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[5] In Burford v. Sun Oil Co., supra, the Court reviewed a District Court decision which dismissed a challenge to an order of the Texas Railroad Commission on the grounds that the parties should pursue the litigation in the Texas courts. The Court affirmed, noting the Railroad Commission's plan of regulation was "of vital interest to the general public" (319 U.S. at 324), and directed that the federal questions raised in the case be litigated through the State court system with final review in the U.S. Supreme Court. Id. at 334. The Court was clearly concerned that piecemeal review of individual Railroad Commission decisions by Federal courts (when Texas had an adequate State court system) would disrupt the State's regulatory program. Id.

[6] In Younger, supra, the Court reversed a District Court order enjoining a State criminal prosecution of the crime of criminal syndicalism. 401 U.S. at 40. The Court determined that despite the Federal government's interest in protecting Federal rights, Federal court jurisdiction should not "unduly interfere with the legitimate activities of the States." Id. at 44. In subsequent decisions, the Court has expanded the Younger doctrine to include, inter alia, ongoing State administrative proceedings, Ohio Civil Rights Commission v. Dayton Christian Schools, Inc., 477 U.S. 619 (1986), and State civil proceedings, Juidice v. Vail, 430 U.S. 327 (1977).

of State regulation of the retail rates of electric utilities, even in cases in which preemption of such State regulation was ultimately found. Indeed, as the Fifth Circuit described, regulation of retail rate levels, as well as generation facilities and intrastate transmission, falls on the State side of the "bright line" described by this Court in FPC v. Southern California Edison Co., 376 U.S. 205, 215 (1964), thereby establishing a "dichotomy of supervision" that will occasionally and foreseeably result in conflicts between State and Federal jurisdiction. App. at 14A. A "dichotomy of supervision", however, does not diminish the State's interest in the impact of Federal policies on retail service, as this Court recognized when it upheld a State decision to ban nuclear plant construction, an issue of pervasive Federal regulation, on the basis of the State's concern with

the with the cost of nuclear waste disposal. Pacific Gas and Electric Co. v. State Energy Resources Commission, 461 U.S. 190 (1983).

The fact that these seemingly inevitable conflicts will occur does not mean, however, that State or local regulatory bodies forfeit their legitimate interest in protecting their citizens from exploitive utility pricing policies simply because the utility alleges a "federal right" to the recovery of its purchased power costs. Nor does it mean that State courts should be ousted from their traditional role of reviewing questions of both State and Federal law raised in State commission rate orders.

As the language quoted from Nantahala and MP&L, supra at 13-14, indicates, this Court has not precluded all State review of whether or not it is reasonable to permit a utility to pass through to retail

ratepayers FERC-approved purchased power costs and allocations.[7] Indeed, the Court has never ruled on the merits of the specific issue that NOPSI seeks to litigate in Federal court: whether or not State or local regulatory agencies may find a utility to have acted imprudently by failing to attempt to resell an allocation of purchased power approved by the FERC. Because that specific issue has not been resolved, NOPSI cannot fairly claim, nor accurately predict, that this Court would inevitably preempt the Council's careful and extensive rate order once the issue came to the Court on the merits. If the issue is not finally settled--and it is not--NOPSI can hardly claim that there are only Federal issues at stake in this case for the simple reason that a final decision

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[7] See Nantahala, supra, at 972, citing Pike County Light & Power Co. v. Pennsylvania Public Utility Commission, 465 A.2d 735 (1983).

on the merits upholding the Council's exercise of jurisdiction would firmly establish the Council's legitimate interest in determining why NOPSI failed to reduce the risks it faced with respect to Grand Gulf as it once acknowledged it could. App. at 10A.

Of course, the merits of this issue are not before this Court, but rather, are now before the courts of the State of Louisiana. NOPSI Br. at 15. NOPSI does not, and fairly cannot, claim that the Louisiana court system is incapable of hearing and resolving its claim of Federal preemption. Id. Indeed, many of the preemption cases decided by the Court in recent years in the electric utility regulatory sphere have been litigated through the State court system.[8] Prior to

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[8] MP&L, supra, Duquesne Light, supra, Arkansas Electric Cooperative, supra, and Nantahala, supra, each involved Supreme Court review of State court rulings. In Duquesne Light and Arkansas Electric Cooperative, State court decisions involving federal questions were upheld.

this Court's decision in Nantahala, the major ruling on the question of State jurisdiction to regulate the passthrough of FERC-approved purchased power costs was the Rhode Island Supreme Court's Narragansett decision.[9]

In sum, the case before the Court as it now stands involves the following salient aspects: the specific issue of Federal preemption that NOPSI wishes to litigate in Federal court is a matter of first impression which neither this Court nor any other Federal court has yet addressed; the courts of the State of Louisiana are competent to hear and decide this preemption issue; NOPSI has the opportunity to litigate its claim in State

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[9] Narragansett Electric Co. v. Burke, 119 R.I. 559, 381 A.2d 1358 (1977), cert. den., 435 U.S. 972 (1978). Here, the Rhode Island Court found its State commission's jurisdiction to be preempted due to FERC wholesale regulation.

court, and indeed is now so doing; and the final outcome of the litigation on the prudence issue will directly affect the retail ratepayers of the City of New Orleans, in whose behalf the Council exercises its ratemaking authority. In light of these factors, the Fifth Circuit balanced the importance and strength of the Federal claims alleged by NOPSI against the important regulatory interests of the Council, and concluded that the District Court's decision to abstain was proper. In light of these same factors, this Court should affirm the decision below.

- The Court should affirm for the additional reason that Federal court involvement in State ratemaking decisions will serve to disrupt the development of new State regulatory policies and procedures. At the end of its decision in Duquesne Light, the Court alluded to impending changes in the structure of the

electric utility industry which will inevitably affect regulation of retail rates and services. Beginning in 1978 with the passage of Section 210 of the Public Utility Regulatory Policies Act of 1978, codified at 16 U.S.C. sec. 824a-3 (1985)(PURPA), policies at both the Federal and State levels have begun to erode the monopoly characteristics of electric utility control of generating capacity.[10] PURPA reduced barriers to entry which had previously prevented non-utility cogenerators and small power producers from selling power into electric distribution markets. In recent years, the FERC has proposed to reduce its wholesale regulation of so-called independent power producers--non-utility generators with no distribution

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[10] See Federal Energy Regulatory Commission v. Mississippi, 456 U.S. 742, 750-751 (1982) for a description of the deregulatory goals of PURPA.

facilities or retail customers.[11] This FERC initiative, which is pending at the Commission, reflects the development of new methods of regulation at the State level which seek to inject greater competition into generating markets. State commissions have begun to experiment with competitive bidding systems in which utilities conduct auctions to acquire access to third-party generating capacity for service to retail consumers.[12] Patterned on PURPA, these State bidding programs seek to encourage utilities to consider third-party producers in order to acquire incremental generating capacity at the lowest available cost.[13]

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[11] See Notice of Proposed Rulemaking, Regulations Governing Independent Power Producers, IV F.E.R.C. Stats. & Regs. para. 32,456, 53 Fed. Reg. 9327 (1988).

[12] See Notice of Proposed Rulemaking, Regulations Governing Bidding Programs, IV F.E.R.C. Stats. & Regs. para. 32,455, 53 Fed. Reg. 9324 (1988).

[13] See Griggs, Competitive Bidding and Independent Power Producers: Is Deregulation Coming to the Electric Utility Industry?, 9 Energy L.J. 415 (1988).

Necessarily, these complex new State initiatives will require a period of experimentation. Further, because many of these programs involve efforts to rely upon the growing number of competitors in wholesale power markets, new State resource acquisition plans can be expected to raise "federal issues", including questions involving the reasonableness of passing through the costs of bulk power purchases in retail rates.

There can be little doubt that the potential for piecemeal review in Federal District Court of such "federal issues" will disrupt the efforts of the State commissions to manage the impending transition to more competitive power markets. Should the Court reverse in this case, State commissions in the process of developing bidding systems will be exposed to Federal court challenge not only from

traditional utilities like NOPSI, but also from a host of third party producers alleging violations of their Federal rights, hindering the States' ability to develop coherent regulatory programs.

In Duquesne Light, the Court concluded its opinion by stating that "[t]he Constitution within broad limits leaves the States free to decide what rate-setting methodology best meets their needs in balancing the interests of the utility and the public." 488 U.S. at ___, 102 L. Ed.2d at 663. We respectfully urge the Court to affirm the decision below to preserve the flexibility necessary for the States and their regulatory bodies to regulate in the public interest free from the specter of Federal injunction.

CONCLUSION

The Court should affirm the judgment below.

Respectfully submitted,

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